

AN EVALUATION

*University of Wisconsin  
Hospital and Clinics Authority*

*01-12*

*June 2001*

**2001-2002 Joint Legislative Audit Committee Members**

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June 21, 2001

Senator Gary R. George and  
Representative Joseph Leibham, Co-chairpersons  
Joint Legislative Audit Committee  
State Capitol  
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

As required by s. 13.94(1)(o), Wis. Stats., we have completed an evaluation of the implementation and operating agreements between the University of Wisconsin (UW) and the UW Hospital and Clinics Authority. The Authority is an independent, nonprofit entity established by the Legislature in 1996 to operate the 536-bed hospital and a number of clinics on the UW-Madison campus, as well as other outpatient clinics and facilities in the Madison area. In fiscal year (FY) 1999-2000, the Authority had revenue of \$400.0 million and operating expenses of \$395.0 million; in September 2000, it employed 4,263 full-time equivalent staff.

The Authority was created to allow increased management flexibility in hospital operations and greater competitiveness in a changing health care environment. Although it has not engaged in networking activities to the extent that had been envisioned at the time it was established, it has established relationships with a number of health care entities. It has also used the \$106.5 million in bonding authority authorized by the Legislature to engage in an aggressive building program, including construction of two outpatient clinics in Madison.

The Authority's financial performance, like that of other academic medical centers, has been mixed. Revenue in excess of expenses declined from \$13.8 million in FY 1996-97, the Authority's first year of operation, to \$5.0 million in FY 1999-2000; however, it increased during the first ten months of FY 2000-01.

The Authority is generally fulfilling its statutory mission of delivering comprehensive, high-quality health care, including charity care; providing medical instruction; sponsoring and supporting health care research; and providing medical outreach services statewide. In FY 1999-2000, the Authority transferred \$16.3 million to UW medical, nursing, and pharmacy schools and spent directly another \$14.7 million in support of medical education.

We appreciate the courtesy and cooperation extended to us by the Authority. The Authority's response is Appendix 5.

Respectfully submitted,

Janice Mueller  
State Auditor

JM/DB/ao



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## Summary

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The University of Wisconsin Hospital and Clinics Authority is an independent, nonprofit public entity that was established in 1996 to allow the University of Wisconsin Hospital and Clinics (UWHC) to operate with increased flexibility. The Authority operates a 536-bed teaching hospital and a number of clinics that had been operated as part of the University of Wisconsin (UW)-Madison, as well as other outpatient clinics and facilities in the Madison area. Its four-part statutory mission includes patient care, medical education, research, and public service. In fiscal year (FY) 1999-2000, the Authority's revenue was \$400.0 million and its expenses were \$395.0 million. In September 2000, it employed 4,263 full-time equivalent staff.

1995 Wisconsin Act 27, which created the Authority, also required it to enter into a series of agreements with the Board of Regents, including an affiliation agreement that defines the relationship between the Authority and UW-Madison, and a lease that allows the Authority to use state-owned property. In addition, the two parties entered into a conveyance agreement that transferred various assets and liabilities from UW-Madison to the Authority, and an operating and services agreement. Statutes require the Legislature's Joint Committee on Finance to review the affiliation agreement and the lease before June 29, 2001, to determine whether these agreements should be continued or modified. They also direct the Legislative Audit Bureau to conduct an evaluation of the agreements. Therefore, we determined whether the Authority and the Board of Regents have adhered to the agreements they signed; reviewed the Authority's networking activities and its capital acquisition, personnel, and purchasing practices; and examined the Authority's financial and operational performance.

The agreements have resulted in significant ongoing cash transfers between the Authority and UW-Madison. For example, in FY 1999-2000, the Authority paid \$32.9 million to UW-Madison, including funds to support medical education. Similarly, UW-Madison paid the Authority \$12.5 million for various supplies and services, as well as salaries for staff of the Authority who provide services to UW-Madison. Officials of the Authority and UW-Madison are generally satisfied with the agreements and the working relationship the agreements define, and except in a few minor instances they have complied with the agreements' requirements.

To compete in the health care market more effectively, the Authority has established relationships with a number of entities that operate under the name UW Health, including approximately 50 outpatient clinics.

Among these are clinics that had been operated by Physicians Plus Medical Group, S.C., a 225-member physician practice plan that was acquired by the UW Medical Foundation in 1998 and currently operates as a separate division within it. The Joint Committee on Finance recently voted to make tax-exempt, beginning in January 2002, property owned or leased by the UW Medical Foundation.

Although it has developed relationships with other entities, the Authority has not engaged in networking activities to the extent that had been envisioned at the time of its creation. On the other hand, the Authority has taken advantage of its increased operational flexibility to engage in an aggressive building program. Statutes allow the Authority to issue up to \$106.5 million in bonds for any purpose. As of March 2000, the Authority had issued bonds to the full extent allowed by statutes. The Governor's 2001-03 Biennial Budget Proposal recommends increasing the Authority's bonding limit to \$175.0 million.

Despite its nonprofit status, the Authority must maintain a strong financial position to operate effectively in a changing health care environment and support a mission that includes medical education, research, public service, and charity care. To date, its financial performance, like that of other academic medical centers, has been mixed. Total revenue has exceeded expenses in each year since the Authority's creation, but operating revenue has increased less rapidly than operating expenses. As a result, revenue in excess of expenses, or "profits," declined from 4.3 percent of revenue in the Authority's first year of operation to 1.3 percent in FY 1999-2000. However, these "profits" increased to 4.9 percent of revenue in the first ten months of FY 2000-01.

The Authority's cash reserves exceeded the level that had been maintained at the time of its creation but have fallen since June 1997. Statutes require the Authority to retain a minimum level of cash reserves recommended by an independent auditor. However, the Authority's auditor has declined to recommend a specific level of cash reserves; instead, it has suggested a range based on other hospitals' reserves. Authority officials indicate they try to maintain the Standard & Poor's median for hospitals rated "A." While the Authority's cash reserves are within the range suggested by its auditor, they have declined in three of the last four years. If the cash reserves were to fall below the recommended range, the Authority's creditworthiness would be affected, which would in turn affect its ability to finance facility and equipment improvements.

In contrast to declines in profitability and cash reserves, the number of inpatient admissions to UW Hospital increased 5.0 percent from FY 1995-96, the year before the Authority was established, through FY 1999-2000. During the same period, UW Hospital's average daily census remained relatively constant, ranging from 337 patients in

FY 1997-98 to 352 in FY 1998-99. Its occupancy rate during this period ranged from 71.7 percent to 76.4 percent. Outpatient clinic visits increased from 342,405 in FY 1995-96 to 442,339 in FY 1999-2000, or by 29.2 percent; net revenue from outpatient services represented 35.8 percent of net patient service revenue in FY 1999-2000, compared to 28.7 percent in FY 1996-97.

Although there have been mixed trends in the Authority's financial and operational performance during the first four years, officials believe that overall performance will improve and that the Authority is well-positioned to compete in the health care market. Nevertheless, these mixed trends in financial and operational performance suggest that continued scrutiny by the Legislature may be warranted to ensure the Authority continues to meet its statutory mission.

A variety of measures indicate that the Authority is maintaining the high level of service that UWHC had provided when it was operated by UW-Madison. As part of its mission to provide patient care, the Authority reduces or forgives the cost of medical services to certain qualified individuals. In FY 1999-2000, this charity care totaled \$7.3 million and had increased 15.9 percent from the level provided before the Authority was established. The proportion of gross patient revenue the Authority has devoted to charity care in recent years is comparable to charity care levels at 12 other large Wisconsin hospitals.

The Authority also appears to have maintained and in some cases increased its support of medical education at UW-Madison. Deans of the medical, nursing, and pharmacy schools are satisfied with the level of financial support, which includes direct transfers that increased from \$13.1 million in FY 1996-97 to \$16.3 million in FY 1999-2000, and direct expenditures for medical education that increased from \$12.7 million to \$14.7 million in the same period. The Authority also transferred \$6.3 million to support capital expenditures of the UW Medical School. It pays \$79,864 annually to lease property from the UW Medical School and provides additional indirect support, but officials do not maintain the records needed to determine the value of this support.

Officials of the Authority and of UW-Madison indicate that support for medical research has been maintained at the same level provided when UWHC was operated by UW-Madison. The Authority does not provide a significant amount of direct funding for health care research, but it does provide research space and services. For example, it operates a general clinical research center where studies funded by the National Science Foundation are conducted, as well as a clinic that houses the Women's Health Initiative, which conducts research on breast cancer and osteoporosis. Medical professionals at UWHC also conduct clinical trials of new drugs, technology, and procedures. We were unable to quantify the overall value of outreach activities sponsored by the

Authority, but officials believe they are at least maintaining the level of effort that had been provided in the past.

In advocating for the Authority's creation, UWHC officials had contended that the hospital's operations were constrained by excessive oversight, especially related to capital acquisition, personnel, and purchasing. Capital acquisition procedures have changed considerably since the Authority's creation. Now, the Authority can complete projects on state-owned land if they cost less than a specified threshold—which was \$277,800 in FY 2000-01—without obtaining outside approval and review. In its first four years of operation, 103 of the Authority's 109 projects fell below the threshold. Projects on state-owned land that cost more than the threshold continue to require review by UW-Madison, the Board of Regents, and the Department of Administration.

The Authority also gained considerable flexibility in personnel management, which officials indicate has addressed many concerns that were raised before the Authority's creation. For example, the Authority now has responsibility for recruiting and supervising all UWHC staff. It also assigns employees to specific job classifications, and it bargains separately with represented employees' unions. Staff increased from 3,803 in September 1997 to 4,263 in September 2000, or by 12.1 percent. Under a contractual services agreement, 1,917 blue-collar, technical, and administrative staff remain employees of a state agency that receives its entire budget—\$67.5 million in FY 2000-01—from the Authority.

The Authority was able to promptly negotiate three of its four union contracts for 2001-2003, but negotiations for the nurses' contract have been protracted, and the nurses' union filed an unfair labor practices complaint with the Wisconsin Employment Relations Commission on May 15, 2001. While issues between the Authority and the nurses' union are complex, many appear to be influenced by the difficulty the Authority has had in employing and retaining a sufficient number of nurses, especially inpatient nurses.

Authority and union officials have separately indicated that currently, salaries overall are generally competitive and that recruitment and retention difficulties are caused, in part, by a general shortage of nurses nationwide. However, union officials also cited the greater use of forced overtime at the Authority as a factor contributing to retention difficulties. Nurses' union data, which we adjusted to reflect differences in staff sizes, indicate the Authority required extra shifts four times more often than extra shifts at UW Hospital were required by Meriter Hospital in 2000. The Authority indicates that its nurses worked 2,598 mandated extra shifts in 2000, which is an average of 3.35 mandated extra shifts per nurse. It should be noted that because some hospital and clinic units may require mandated overtime more

frequently than others, the experience of an individual nurse may vary considerably from the average. For example, information from the Authority indicates that 12 percent of nurses had six or more mandated shifts in the prior 12 months, while 88 percent had five or fewer such shifts.

Authority officials indicate they are continuing to take steps to lower their nurse vacancy rate, which should reduce the need for mandatory extra shifts. The vacancy rate has declined from 21.0 percent in July 2000 to 11.6 percent in May 2001. Nevertheless, the officials indicate that because of the large number of specialty beds they have, they need to recruit relatively larger numbers of nurses with specialized training than surrounding hospitals. Consequently, recruitment and retention will continue to be challenging.

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## Introduction

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### **The Authority is an independent public entity that began operation on June 29, 1996.**

The University of Wisconsin Hospital and Clinics Authority is an independent, nonprofit public entity that was created on June 29, 1996, to allow the University of Wisconsin Hospital and Clinics (UWHC) to operate with increased flexibility. The Authority operates a 536-bed teaching hospital and a number of clinics that had been operated as part of the University of Wisconsin (UW)-Madison, as well as other outpatient clinics and facilities in the Madison area. Its four-part mission, which is mandated in statutes, includes patient care, medical education, research, and public service. In fiscal year (FY) 1999-2000, the Authority's revenue was \$400.0 million, and its expenses were \$395.0 million. In September 2000, it employed 4,263 full-time equivalent (FTE) staff. The Authority is governed by a 15-member board of directors, which appoints the chief executive officer. Appendix 1 describes the board's membership, which includes members of the Legislature, the Board of Regents, and gubernatorial appointees.

The Authority was created in 1995 Wisconsin Act 27, the 1995-97 Biennial Budget Act, in response to concerns that if UWHC could not respond rapidly to changes in the health care market and compete successfully with other local and regional medical facilities, its ability to continue to deliver high-quality patient care and to provide continued financial support for medical education at UW-Madison would be jeopardized. UWHC officials also asserted that their purchasing, personnel, and capital acquisition activities were excessively constrained by state and university oversight requirements.

The legislation that created the Authority also required it to enter into an affiliation agreement with the Board of Regents that defines the relationship between the Authority and UW-Madison and specifies the amount of annual financial support the Authority will provide for medical education at UW-Madison, as well as a lease that allows the Authority to use state-owned property and specifies the amount the Authority will pay the State to lease the Clinical Sciences Center, which houses the hospital, clinics, and other facilities on the UW-Madison campus. Statutes also provide the Authority with the ability to issue bonds for any purpose up to a limit established by the Legislature, which is currently \$106.5 million.

In addition, statutes require the Joint Committee on Finance to review the affiliation agreement and the lease before June 29, 2001, and every five years thereafter, to determine whether these agreements should be continued or modified. Section 13.94(1)(o), Wis. Stats., directs the Legislative Audit Bureau to conduct an evaluation of the agreements.

Therefore, we:

- determined whether the Authority and the Board of Regents have adhered to the primary provisions of the affiliation agreement and lease, as well as other agreements they signed;
- reviewed the Authority's networking affiliations with other health-related organizations;
- examined the Authority's financial and operating performance and the extent to which it has fulfilled its statutory mission; and
- examined whether the restructuring has allowed the Authority to improve its capital acquisition, personnel, and purchasing processes.

In conducting this evaluation, we spoke with officials of the Authority and the University, including the deans of the UW Medical School, the UW School of Nursing, and the UW School of Pharmacy; reviewed the contracts and agreements between the Authority and the Board of Regents; reviewed available data and other information concerning the Authority's finances and operations, including the amount of support it provides for medical education; analyzed comparative data for other Wisconsin hospitals; and reviewed statistics on academic medical centers nationwide.

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## Agreements with the University of Wisconsin Board of Regents

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### Several agreements define the relationship between the Authority and UW-Madison.

In addition to the affiliation agreement that defines the relationship between the Authority and UW-Madison and a lease that allows the Authority to use state-owned property, the Authority and the Board of Regents have entered into a conveyance agreement that transferred various assets and liabilities from UW-Madison to the Authority, and an operating and services agreement. The affiliation agreement and the lease include all statutorily required provisions, and officials of the Authority and UW-Madison are generally satisfied with all of the agreements and the working relationships the agreements define. However, the Authority has not complied with a small number of technical requirements.

### Affiliation Agreement

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### An affiliation agreement stipulates the Authority's support for medical education at UW-Madison.

The affiliation agreement, which was signed in 1996, helps to ensure that the Authority fulfills its statutory mission, including maintaining the level of financial support for medical education at UW-Madison that had been provided by UW-Madison before June 1996. The agreement has a term of 30 years and is automatically extended for 1 year each July 1 unless termination procedures are exercised. Section 233.04(7m), Wis. Stats., requires the affiliation agreement to contain provisions that ensure:

- the Authority financially supports UW-Madison's medical educational, clinical, and research activities;
- the Authority maintains cash reserves at a level recommended by an independent auditor;
- the Authority develops standards for the selection and financing of any corporation or partnership that provides health-related services, and these standards are consistent with the Authority's and the Board of Regents' missions; and
- the Board of Regents establishes reasonable charges for any services that it provides the Authority.

In addition to these statutory provisions, the affiliation agreement sets forth the broad principles that govern the relationship between the Authority and the Board of Regents, including recognition of how each entity's planning efforts can affect the other. For example, the Authority

and the Board of Regents have each agreed to consider the effect of their plans on the other's mission and to cooperate in conducting research.

The affiliation agreement also specifies the responsibilities of the Authority and the Board of Regents in such areas as personnel, education, research, and external relations. For example, the Authority and UW-Madison fund a joint public affairs office in order to present a unified image to the public. Each must also notify the other regarding changes to personnel policies. Finally, because UWHC had previously used the UW Foundation—an independent, nonprofit, tax-exempt corporation that attempts to secure private financial support for UW-Madison—for its fund-raising efforts, it was agreed that the Authority would continue to do so.

### Lease

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**The Authority has signed a 30-year lease for all on-campus facilities it occupies.**

Construction of the 480,000 square foot Clinical Sciences Center, which contains the 536-bed UW Hospital, outpatient clinics, and other facilities, was completed in 1979 at a cost of \$101.5 million. It was one of the most ambitious capital construction projects ever undertaken by the State. A lease between the Authority and the Board of Regents was executed in 1996 to protect this investment and other on-campus facilities the State owns. Statutes allow a lease term of up to 30 years. Like the affiliation agreement, with which it runs concurrently, the lease is automatically extended each July 1 for an additional year unless termination procedures are exercised by either party. Statutes stipulate that the lease contain other provisions requiring:

- the Authority to pay annual rent of \$1.00 plus an amount equaling the debt service on all outstanding bonds issued by the State to finance the construction of the Clinical Sciences Center and other on-campus facilities that the Authority leases;
- the State to own any facility that the Authority constructs on state-owned land, as well as any modifications the Authority makes to on-campus facilities; and
- the Board of Regents to be protected from all liability associated with the Authority's management and use of the on-campus facilities.

In addition to the required provisions, the lease contains provisions to protect the State's interest in its property. Under these provisions, the Authority must:

- use the Clinical Sciences Center and other on-campus facilities to further its statutory mission;
- furnish the State Building Commission with the opinion of a nationally recognized bond counsel if it sublets any portion of the leased facilities, because subletting a significant portion of the building could affect bondholders' financial interests and the Authority's tax-exempt status; and
- pay maintenance expenses for interior common space within the Clinical Sciences Center, based on the proportion of space it occupies.

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**The Authority leases 58 percent of the Clinical Sciences Center on the UW-Madison campus.**

Since the Authority's creation, it has leased 58 percent of the Clinical Sciences Center. UW-Madison occupies the remaining 42 percent, using it for instruction, research, and laboratory work that supports medical education.

Authority and UW-Madison officials believe that the terms of the lease have worked well, and both parties have complied with it substantially. However, we noted a few minor instances in which the Authority and UW-Madison have not complied with some requirements. For example, the Authority did not obtain the opinion of bond counsel when it sublet 352 square feet in the Clinical Sciences Center to University Health Care, Inc., a nonprofit corporation that is partially controlled by the Authority, or 458 square feet to Ameritech for telephone wiring. Authority officials did not obtain the bond counsel's opinion because they considered the subleases a continuation of arrangements that predated the Authority's creation, and the amount of space that was sublet was insignificant.

In addition, the Authority did not charge UW-Madison for its share of maintenance expenses for the interior common space within the Clinical Sciences Center from June 1996 through October 2000. Under the terms of the lease, we estimate UW-Madison should have paid approximately \$189,350, or 42 percent of total maintenance costs incurred by the Authority from FY 1996-97 through FY 1999-2000, based on the proportion of space UW-Madison occupies in the building. Authority officials attributed this oversight to improper computer coding and indicated that UW-Madison was properly charged for maintenance expenses beginning in November 2000.

## Conveyance Agreement

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**A conveyance agreement transferred assets and liabilities to the Authority.**

To facilitate the June 1996 restructuring, the two parties entered into a conveyance agreement that transferred from UW-Madison to the Authority UWHC's:

- assets and liabilities;
- tangible personal property, including UWHC patient and financial records;
- contracts, including leases for all equipment used by UWHC; and
- Personnel Commission cases, unemployment compensation claims, and other pending personnel matters.

As shown in Table 1, the \$103.0 million transferred from UW-Madison to the Authority included \$101.2 million that had previously been managed by the State of Wisconsin Investment Board. State funds shown in the table are the unencumbered balance of UW-Madison's 1995-96 appropriation for UWHC, which 1995 Wisconsin Act 27 required to be transferred to the Authority. Act 27 also required UWHC to transfer \$15.0 million to the General Fund.

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Table 1

**Assets Transferred to the Authority**  
1996

<u>Type of Asset</u>	<u>Amount</u>
Investments*	\$101,195,288
State Funds	1,362,906
Gifts and Grants	399,262
Student Loans	<u>45,932</u>
Total	\$103,003,388

\* These investments, which consist of various marketable securities used for capital replacement, bond indenture, and debt retirement purposes, had been managed by the State of Wisconsin Investment Board and are now managed by the UW Foundation.

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## Operating and Services Agreement

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**An operating and services agreement addresses various aspects of the Authority's operations.**

The Authority is permitted by 1995 Wisconsin Act 27 to enter into agreements with the Board of Regents as is necessary or convenient for its mission. Accordingly, in June 1996 the parties entered into an operating and services agreement that addresses such areas as:

- security, landscaping, and snow removal;
- Authority employees' access to the University's facilities, such as sports complexes and libraries;
- the use of trade names, trademarks, service marks, and logos;
- payment of utility expenses, such as electricity, water, and sewer services;
- parking arrangements and the use of the University's fleet vehicles; and
- the use of the University's state and federal environmental permits for the Authority's operations.

## Transfers between the Parties

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**The Authority paid \$32.9 million to UW-Madison in FY 1999-2000.**

Execution of these agreements has resulted in significant ongoing cash transfers between the two parties. As shown in Table 2, the Authority paid UW-Madison \$32.9 million in FY 1999-2000 for its share of the services provided under the various agreements. All amounts the Authority pays UW-Madison are reflected in state appropriations.

Table 2

**The Authority's Payments to UW-Madison\***  
 FY 1996-97 through FY 1999-2000  
 (in millions)

	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change for Period</u>
Affiliation Agreement	\$13.1	\$14.5	\$18.4	\$18.5	41.2%
Operating and Services Agreement	10.5	10.6	10.4	10.9	3.8
Other**	<u>2.5</u>	<u>3.1</u>	<u>3.1</u>	<u>3.5</u>	40.0
Total	\$26.1	\$28.2	\$31.9	\$32.9	26.1

\* The Authority also pays the Department of Administration for the debt service on all outstanding bonds issued by the State to finance the construction of the Clinical Sciences Center. Debt service was approximately \$4.0 million annually from 1997 through 2000.

\*\* Includes funding for services not stipulated in any agreement, such as for services provided by the State Laboratory of Hygiene and other UW-Madison laboratories.

Similarly, the Authority receives payments from UW-Madison for various services that it provides. As shown in Table 3, UW-Madison transferred \$12.5 million to the Authority in FY 1999-2000, including payment for services the Authority provides in support of UW-Madison's research grants and for supplies.

Before the 1996 restructuring, general purpose revenue (GPR) funded 143.0 FTE staff positions at UW-Madison that also provided services to UWHC. When the Authority was created, an agreement was reached that divided compensation responsibility between the Authority and UW-Madison for these positions, which include specified clinical pharmacist, medical technician, and custodian positions. UW-Madison agreed to fund 91.27 FTE positions, and the Joint Committee on Finance reduced UW-Madison's GPR position count by 91.27 FTE positions. While the staff in these positions continue to provide services to UW-Madison, they are now employed by the Authority and the UW Hospitals and Clinics Board, a state agency that was created at the time of the restructuring and that has the same board of directors as the Authority. Included in the \$12.5 million that UW-Madison paid the Authority in FY 1999-2000 is approximately \$4.0 million in GPR to help fund these positions, and this amount is reflected in state appropriations.

Table 3

**UW-Madison Payments to the Authority**  
 FY 1996-97 through FY 1999-2000  
 (in millions)

	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change In Period</u>
Salaries and Fringe Benefits	\$6.4	\$ 7.3	\$ 8.7	\$ 9.0	40.6%
Research Grants and Services	0.8	1.2	1.2	1.7	112.5
Supplies	0.7	0.6	0.7	0.6	(14.3)
Other	<u>1.3</u>	<u>1.2</u>	<u>1.0</u>	<u>1.2</u>	(7.7)
Total	\$9.2	\$10.3	\$11.6	\$12.5	35.9

It should be noted that nonstatutory provisions in 1995 Wisconsin Act 27 required the Board of Regents to submit a report on savings resulting from the transfer of UWHC's operations to the Authority. The report indicated UW-Madison would save approximately \$175,600 each year in GPR that had previously been used to provide unreimbursed administrative, legal, human resources, and facilities planning and management services to UWHC. In 1996, the Joint Committee on Finance, using an estimate of higher savings, reduced the University's annual budget by \$237,700 and deleted 2.12 positions to reflect these savings.

Although we found general compliance with the terms of all agreements between the Authority and the Board of Regents, documentation for the amounts transferred from the Authority to UW-Madison could not be completely reconciled to the University's accounting records, and portions of the annual amounts to be transferred under the agreements are frequently provided after the year has been completed. However, officials of both the Authority and UW-Madison are generally satisfied with the terms of the agreements and the process for negotiating the annual adjustments, and they believe no significant changes are needed.

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## Relationships with Health Care–Related Entities

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In the early 1990s, officials of UW-Madison and UWHC believed that in order to compete in the health care market, UWHC needed to form networks with other health care-related entities, such as managed care organizations, in order to share information, financial support, and patients. At the time, officials believed these networks would provide educational opportunities to medical students and provide revenue to ensure UWHC’s financial success.

While the Authority has relationships with a number of entities that operate under the name UW Health including approximately 50 outpatient clinics, it has not engaged in networking activities to the extent that was envisioned at the time of the restructuring because the Authority concluded that other strategies were more effective. Instead, it has used available bonding authority to engage in an aggressive building program to increase the size of its outpatient clinics. In addition, the UW Medical Foundation’s acquisition of the 225-member Physicians Plus Medical Group, S.C., has made it unnecessary for the Authority to consider joint ventures with other physician providers.

### UW Health

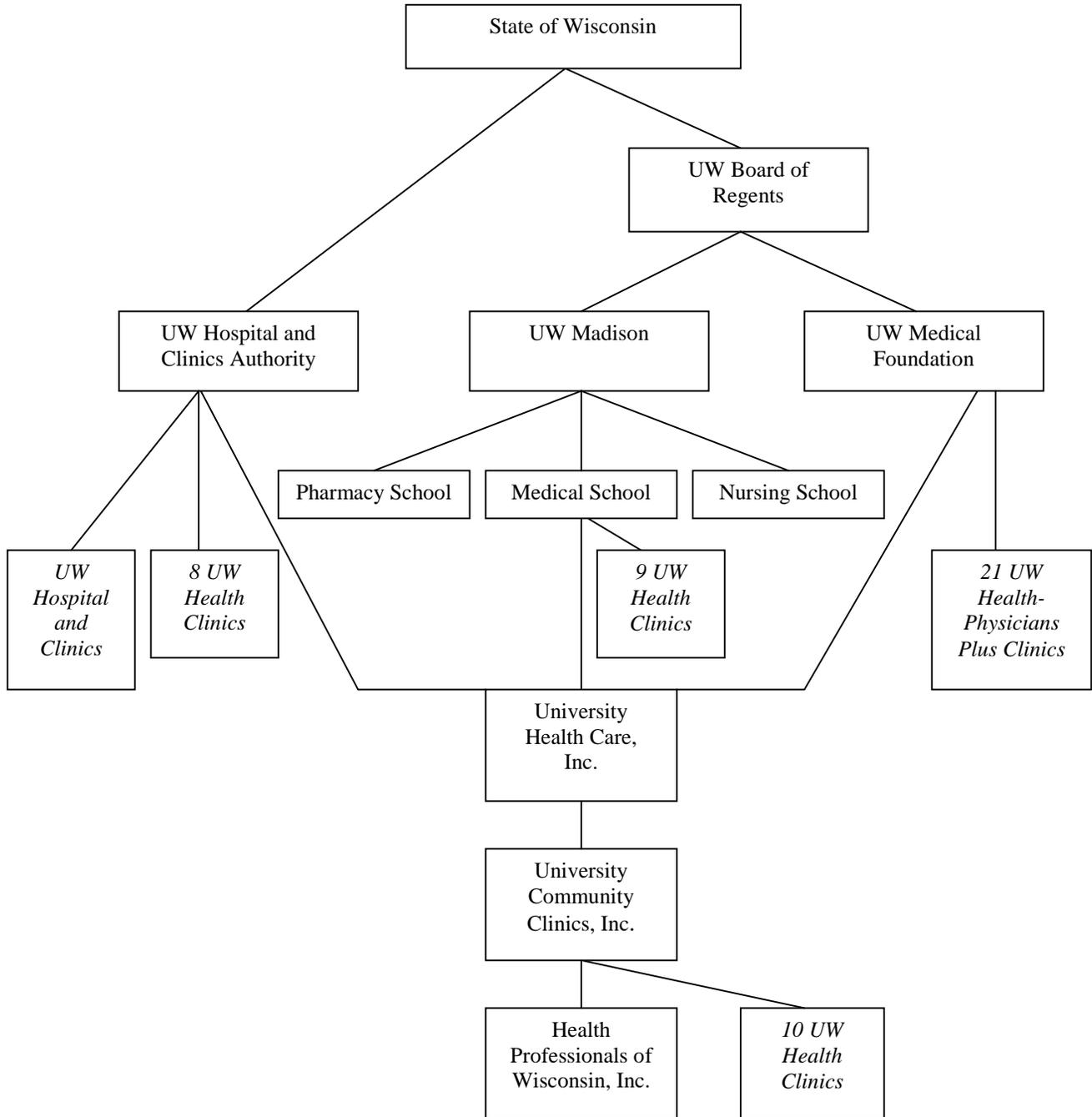
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**The Authority and several other entities operate collaboratively as UW Health.**

The Authority and several other health-related entities collectively use the name UW Health for marketing and public relations purposes. UW Health is a registered trademark of the Board of Regents, which has granted the Authority and other participating parties a royalty-free license for its use. Figure 1 shows the current entities associated with UW Health and their organizational relationships with the State and the Board of Regents. These entities collaborate in the delivery of patient care and the pursuit of their educational and research missions. All of the outpatient clinics currently operating under the name UW Health are listed in Appendix 2.

Figure 1

**Entities Associated with UW Health**



UW Hospital, which is the 536-bed teaching hospital, and a number of clinics housed in the Clinical Sciences Center serve as the primary teaching facility for the UW Medical School, UW School of Nursing, and UW School of Pharmacy. In addition, the Authority is responsible for graduate medical education, which includes training approximately 440 residents each year. The 797 physicians who are members of the UW Medical School faculty serve as the medical staff at UW Hospital, outpatient clinics in the Clinical Sciences Center, and other clinics operated by the Authority. Medical faculty provide patient care and teaching services, and they conduct research.

### **UW Medical Foundation**

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**The UW Medical Foundation handles billing for all physician services.**

The UW Medical Foundation, whose creation in 1995 was authorized by the Board of Regents, is a nonprofit, tax-exempt foundation that operates as a medical education, research, and patient care organization. The UW Medical Foundation functions as the clinical practice plan for the member physicians, handling billing for all physician services provided to patients.

Before May 1995, each of 14 UW Medical School departments was responsible for providing financial support to the UW Medical School from its patient revenue, as well as for managing its own clinical practice. As a result, each department had a medical faculty practice plan to collect physician fees from patients and distribute them among member physicians. In May 1995, the Board of Regents and the UW Medical Foundation entered into an agreement to replace the 14 plans with 1 plan. Under this agreement, the UW Medical Foundation operates exclusively in support of the UW Medical School and contributes a portion of its annual patient revenue generated by medical faculty physicians to the UW Medical School.

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**The UW Medical Foundation paid the UW Medical School \$56.1 million in 1999.**

The agreement provides for three types of financial support to the UW Medical School:

- operating expenses, which are used primarily for faculty and support staff compensation that is not fully funded by UW-Madison;
- the medical school development fund, which is controlled by the dean of the UW Medical School and supplements state and federal appropriations; and

- the departmental research and development fund, which is controlled by departmental chairs and used by each department within the UW Medical School to support research and programmatic expenses.

As shown in Table 4, the UW Medical Foundation’s support for the UW Medical School increased from \$36.5 million in 1997 to \$56.1 million in 1999, the most recent year for which data are available.

Table 4

**UW Medical Foundation Support for the UW Medical School**  
(in millions)

<u>Type of Support</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>Percentage Change</u>
Operating Expenses	\$19.7	\$31.7	\$34.9	77.2%
Medical School Development Fund	11.5	12.8	14.1	22.6
Departmental Research and Development Fund	<u>5.3</u>	<u>6.4</u>	<u>7.1</u>	34.0
Total	\$36.5	\$50.9	\$56.1	53.7

In the mid-1990s, one of the trends in medical care was an increased emphasis on primary care. To increase revenue by expanding the number of physicians at the UW Medical Foundation, as well as to increase the number of primary care physicians available to teach at the UW Medical School, the UW Medical Foundation purchased the 225-member Physicians Plus Medical Group in February 1998. This purchase, which included all Physicians Plus clinics, made the UW Medical Foundation the largest medical group in the state and the eighth-largest in the nation.

**The UW Medical Foundation is attempting to have clinics it purchased exempted from local property taxes.**

Although the purchase of the Physicians Plus Medical Group was completed in 1998, the UW Medical Foundation has experienced operating and other difficulties with the merger, and Physicians Plus continues to operate as a separate division within the UW Medical Foundation. Currently, the UW Medical Foundation plans to integrate Physicians Plus fully by June 30, 2001, although whether it will be able to do so by that date is uncertain. The UW Medical Foundation has also filed a lawsuit in Dane County Circuit Court against nine communities in south-central Wisconsin over the tax status of the Physicians Plus Medical Group clinics it acquired in 1998. The UW Medical Foundation

is attempting to have the clinics removed from local property tax rolls, but the communities have refused. It should be noted that the Legislature's Joint Committee on Finance recently voted to make tax-exempt, beginning in January 2002, property owned by or leased to the UW Medical Foundation. Furthermore, like other UW Medical School physicians, the former Physicians Plus physicians are insured by the State against malpractice claims because they are considered faculty members of the UW Medical School.

### **University Health Care, Inc.**

University Health Care, Inc., and its related subsidiaries provide the main networking relationships of both the Authority and the UW Medical Foundation. University Health Care is a nonstock, nonprofit, tax-exempt corporation originally created in 1983 under the direction of the Board of Regents. Before the Authority was created, UWHC participated in networking activities with University Health Care and its subsidiary, Health Professionals, Inc. However, in 1994 (report 94-5), we found that UWHC and University Health Care were inappropriately using state funds to create a health care network. The Attorney General subsequently concluded in June 1994 that University Health Care's creation was improper because the Board of Regents did not follow statutory procedures; exercise final authority over University Health Care's operations; or impose minimum controls over University Health Care, such as compliance with open meetings and public records laws. Moreover, the Attorney General believed that the activities of Health Professionals, including its acquisition of medical practices, were not authorized or controlled by the Board of Regents. As a result, the Attorney General determined that it was improper for Health Professionals to receive public funds because the necessary accountability of those funds could not be assured. 1995 Wisconsin Act 27, which created the Authority, removed the legal impediments to UWHC's subsidizing, with hospital revenue, the activities of University Health Care and its subsidiaries, because this revenue was no longer considered state funds.

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**University Health Care negotiates health care contracts with insurers and others.**

University Health Care's board of directors currently consists of the Authority's chief executive officer, the UW Medical Foundation's president, the UW Medical School's dean and physician-in-chief, and University Health Care's president. University Health Care now fulfills two roles. First, because insurers, employers, and health maintenance organizations often prefer to negotiate health care contracts with one entity, University Health Care is under contract with the Authority and the UW Medical Foundation to act as their authorized agent in the negotiation of contracts for the provision of hospital and physician services. As of February 2001, University Health Care had entered into approximately 70 of these health-service contracts. Second, University Health Care assists in the development of a regional health care delivery

system. For example, it coordinates the schedules of UW Medical Foundation physicians who provide services at clinics located throughout the state.

### **University Community Clinics, Inc.**

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**University Community Clinics purchases and administers physician practices for UW Health.**

University Health Care's subsidiary, Health Professionals, was subsequently renamed University Community Clinics, Inc. This nonstock, nonprofit corporation purchases and develops local and regional physician practices for UW Health by acquiring, managing, and providing administrative services such as billing, recruitment, and management services. As of June 2001, University Community Clinics operated ten clinics in south-central Wisconsin. University Community Clinics is a partial owner, along with Blue Cross & Blue Shield United of Wisconsin, of Health Professionals of Wisconsin, Inc., a for-profit corporation. Health Professionals of Wisconsin owns the real estate of two University Community Clinics clinics. In 2000, University Community Clinics made \$78,120 in lease payments to Health Professionals of Wisconsin for these two clinics. University Community Clinics' board of directors includes University Health Care's board of directors, University Community Clinics' medical director, a member appointed by the UW Medical Foundation, and a physician employed by University Community Clinics.

The Authority and the UW Medical Foundation—but not the UW Medical School—provide financial support to University Health Care and University Community Clinics. Their contributions fund the administrative costs that University Health Care incurs during its negotiation of health care contracts, as well as those that University Community Clinics incurs during its acquisition of clinical practices. The debt that University Community Clinics incurred in acquiring clinics was a cumulative \$3.4 million in 2000.

The contributions are made through University Health Care, which annually requests funds from the Authority and the UW Medical Foundation on behalf of both itself and University Community Clinics. The Authority and the UW Medical Foundation provide the funds to University Health Care, which subsequently gives a portion to University Community Clinics. As a result, neither organization contributes directly to University Community Clinics. As shown in Table 5, support by the Authority and the UW Medical Foundation for University Health Care and University Community Clinics increased from \$5.3 million in FY 1996-97 to \$6.1 million in FY 1999-2000.

Table 5

**Support for University Health Care and University Community Clinics,  
by Source\***

	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>
University Health Care:				
Authority	\$ 785,417	\$1,087,300	\$1,087,300	\$1,087,300
UW Medical Foundation	<u>755,000</u>	<u>750,000</u>	<u>750,000</u>	<u>750,000</u>
Subtotal	1,540,417	1,837,300	1,837,300	1,837,300
University Community Clinics:				
Authority	2,063,759	3,100,000	3,100,000	3,100,000
UW Medical Foundation	<u>1,649,780</u>	<u>1,200,000</u>	<u>1,200,000</u>	<u>1,200,000</u>
Subtotal	<u>3,713,539</u>	<u>4,300,000</u>	<u>4,300,000</u>	<u>4,300,000</u>
Total	\$5,253,956	\$6,137,300	\$6,137,000	\$6,137,000

\* The UW Medical Foundation's fiscal year corresponds to the calendar year, while the Authority's fiscal year follows the State's.

As noted, the Authority's arrangements with University Health Care and University Community Clinics, including its financial contributions, are now permitted by statutes, and responsibility for managing and overseeing the two entities is shared by the Authority, UW Medical Foundation, and UW Medical School. In addition, UWHC entered into a joint venture in 1994 with Chartwell Midwest, an Illinois general partnership, to provide home infusion services, and the Authority has maintained this arrangement. However, the Authority has not exercised its networking authority to the extent permitted by, for example, entering into new arrangements with other health-related entities, such as joint ventures to provide home health care and long-term care for patients who no longer need hospital services but who cannot live independently.

**Issuance of Bonds**

Since its creation, the Authority has used its ability to issue bonds for any purpose, as provided by s. 233.20, Wis. Stats., to complete a number of projects, including construction of two outpatient clinics in Madison: UW Health-East, and UW Health-West. These projects allow

the Authority to serve additional patients, accommodate new physicians, and compete in the health care market with other providers.

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**The Authority has issued \$106.5 million in bonds to fund construction projects.**

1995 Wisconsin Act 27 limited the Authority to issuing \$50.0 million in bonds, but this limit was increased by \$56.5 million in 1999. As of March 2000, the Authority had issued bonds to its full limit of \$106.5 million. As noted, under its lease with the Board of Regents, the Authority is also responsible for debt service on all outstanding bonds issued by the State to finance construction of the Clinical Sciences Center. The debt service for all of these bonds is included in Appendix 3.

The Authority's bonds are not considered a debt of the State. Nevertheless, it should be noted that to help the Authority purchase bond insurance, the Board of Regents passed a resolution stating that it would not terminate the affiliation agreement or the lease unless the Authority substantially violated either agreement. Further, statutes indicate that in the event of the State terminating the agreements, adequate protection must be provided to the bondholders, which could mean assuming responsibility for any outstanding bond debt.

As shown in Table 6, the Authority used the proceeds from its April 1997 bond issue of \$50.0 million to complete seven projects worth \$54.6 million. Officials explained that they used interest from the bond proceeds and other income to fund the costs in excess of \$50.0 million.

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Table 6

**Projects Funded with April 1997 Bond Revenue**  
(in millions)

<u>Project</u>	<u>Cost</u>
UW Health-West Clinic (June 1999)	\$17.3
UW Health-East Clinic (November 1999)	15.4
Outpatient Treatment Center at Clinical Sciences Center	8.8
Purchase of University Station Clinic	6.9
Portion of Medical School Addition at Clinical Sciences Center	3.6
Linear Accelerator for Radiotherapy Department	0.8
Cardiac Intensive Care Unit at Clinical Sciences Center	0.7
Bond Issuance Costs	<u>1.1</u>
Total	\$54.6

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In March 2000, the Authority issued an additional \$56.5 million in bonds. As shown in Table 7, the Authority plans to fund several projects with the proceeds from this bond issue.

Table 7

**Estimated Cost of Projects to Be Funded  
with March 2000 Bond Revenue**  
(in millions)

<u>Project</u>	<u>Estimated Cost</u>
Expansion of Ambulatory Care Facilities at Clinical Sciences Center	\$24.4
Construction of Additional Operating Rooms at Clinical Sciences Center	17.6
Expansion of Pediatric Intensive Care Unit	5.9
Medical Flight Helicopter Relocation	3.7
Relocation and Equipment Costs of Projects	2.9
Bond Issuance Costs	<u>2.0</u>
Total	\$56.5

**Future Operations**

**The Healthstar initiative is a significant capital building project on the UW-Madison campus.**

All UW Health participants will benefit from a six-year Healthstar initiative, created in the State's 1997-99 capital budget, which was designed to improve health education at UW-Madison. The initiative includes three projects that will be located near the Clinical Sciences Center:

- the \$45.0 million Rennebohm School of Pharmacy building, funded by \$15.0 million in bonds that will be repaid with GPR and \$30.0 million in gifts and grants;
- the \$65.9 million Health Sciences Learning Center, including a library, distance education facilities, and other instructional space, funded by \$41.9 million in bonds that will be repaid with GPR, \$5.9 million in bonds that will be repaid by program revenue, and \$18.1 million in gifts and grants; and

- \$12.0 million for utilities associated with the initiative, funded by bonds that will be repaid with GPR.

University officials also indicate that the Healthstar initiative may eventually fund an interdisciplinary research complex that will conduct molecular, cancer, cardiovascular, and other research.

Authority and UW Medical Foundation officials indicate that restructuring and consolidation of operations of the various clinics owed by the partners in UW Health will be necessary in the future. They note that University Community Clinics' acquisitions, along with the UW Medical Foundation's purchase of the Physicians Plus Medical Group and its clinics, resulted in too many primary care clinics, including several with overlapping service areas. Therefore, University Community Clinics closed and consolidated four primary care clinics between 1999 and 2001, leaving it with eight primary care and two alcohol and drug treatment clinics. Authority officials have stated that University Community Clinics' \$3.4 million debt is being reduced by closing clinics, consolidating operations with Physicians Plus clinics, and implementing administrative changes such as reductions in clinic expenditures. They anticipate that the debt will be eliminated within two years.

Some UW-Madison officials believe greater integration and coordination is needed in managing UW Health clinics. Coordinating patient billing, admissions, and records, for example, would improve efficiency in the clinics' operations. In addition, these officials believe that patient service would be improved if appointment scheduling, admissions information, and other medical records were shared more efficiently when patients are referred among clinics or to UW Hospital, the 536-bed hospital operated by the Authority.

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**The Authority's strategic plan emphasizes coordination with the UW Medical School and the UW Medical Foundation.**

Improved coordination among the participants in UW Health is reflected in the Authority's updated strategic plan, which was adopted by its board of directors in April 2001. The plan emphasizes integration and coordination with the UW Medical School and the UW Medical Foundation and reflects all three organizations' goals. Strategies in the new plan include:

- aligning the strategic, operational, and organizational interests of the Authority, the UW Medical School, and the UW Medical Foundation to ensure a coordinated market approach, including integration of clinic facilities, patient registration and scheduling, and information services to limit duplication, as well as promotion of the UW Health name to minimize confusion regarding patient services;
- developing management and organizational structures to reinforce the Authority's commitment to high-quality customer service;
- adopting a position concerning the Authority's relationship with Meriter Hospital, the Madison hospital at which some Physicians Plus physicians practice, including initiating discussions regarding the need to improve communication and collaboration; and
- positioning the Authority as the preeminent regional referral source through the development of tertiary services in geriatrics, women's services, and children's services that focus on clinical programs in transplants, cardiology, oncology, neuroscience, and trauma-critical care.

These goals are similar to those articulated in the UW Medical School's 1998-2000 strategic plan, which identified efforts to integrate planning, management, and communication among the three primary members of UW Health: the Authority, the UW Medical School, and the UW Medical Foundation.

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## Financial and Operational Performance

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### **The Authority's financial and operational performance has been mixed.**

To continue its mission of providing high-quality health care and supporting medical education, the Authority must maintain a strong financial position. Like academic medical centers nationwide, the Authority's financial performance has been mixed. Revenue in excess of expenses declined from \$13.8 million in FY 1996-97, the Authority's first year of operation, to \$5.0 million in FY 1999-2000, but it increased during the first ten months of FY 2000-01. Various measures of operating performance were generally positive during the Authority's first four years, but they declined during the first ten months of FY 2000-01.

### **Issues Facing Academic Medical Centers**

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### **Academic medical centers face challenges that other hospitals do not.**

Like other operators of academic medical centers, the Authority faces financial and operational issues that typically do not affect other types of hospitals. Academic medical centers often provide highly specialized care and services that may not be readily available elsewhere. They also conduct medical research and provide medical education, and they tend to serve patients with more complex medical needs and conditions. The health care environment has been particularly challenging for academic medical centers in recent years, as costs have outpaced reimbursements from government programs and managed care organizations. As a result, a number of academic medical centers nationwide have suffered financially.

Nationwide, occupancy rates have fallen at all types of hospitals since the late 1980s, in part because new technology allows many services that once required hospitalization to be provided on an outpatient basis. In addition, more individuals now receive health care through managed care organizations, which try to limit hospitalization costs. Finally, health care providers in many local markets have begun to compete more aggressively for patients, resulting in fewer patients for some hospitals.

In response to this changing health care environment, many academic medical centers have tried to generate revenue by adding staff and inpatient beds, opening primary care clinics, merging with other hospitals, or purchasing physicians' practices. However, these strategies have not always been successful. One study found that almost half of 750 hospital mergers between 1993 and 1997 had not resulted in the expected economic advantages. For example, the Allegheny Health, Education, and Research Foundation in Pennsylvania grew from a

740-bed hospital with \$195 million in revenue in 1986 to a consortium of 14 hospitals with 4,601 beds and \$2.2 billion in revenue in 1997. However, it accumulated \$1.3 billion in debt and declared bankruptcy in 1998.

Academic medical centers faced reductions in Medicare and Medical Assistance reimbursements when the federal Balanced Budget Act of 1997 reduced Medicare funding by \$116 billion and Medical Assistance funding by \$15 billion from 1998 to 2002. Some funding cuts, such as reductions in inflation updates for Medicare patient service payments, affected all hospitals. However, academic medical centers were specifically affected by others, such as reductions in payments for graduate medical education. In FY 1996-97, the Authority received 32.9 percent of its net patient revenue from Medicare, and 5.0 percent from Medical Assistance. In FY 1999-2000, Medicare provided 27.8 percent of net patient revenue, while Medical Assistance provided 3.8 percent.

To help mitigate funding reductions, the federal Balanced Budget Refinement Act of 1999 provided \$7.3 billion in additional revenue to hospitals. As a result, the Authority estimates it will receive an additional \$3.2 million from Medicare in FY 2000-01.

### **Financial Trends**

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**The Authority's  
profitability declined to  
1.3 percent of revenue in  
FY 1999-2000.**

As shown in Table 8, both operating revenue and expenses increased in each of the four years since the Authority assumed responsibility for UWHC at the close of FY 1995-96. Net operating income generally declined, reaching a low of -\$2.2 million in FY 1999-2000. With the addition of non-operating revenue, which is primarily investment income, the Authority's revenue in excess of expenses, or "profit," was \$5.0 million, or 1.3 percent of revenue, in FY 1999-2000. In contrast, revenue in excess of expenses was \$13.3 million, or 4.3 percent of revenue, the year before the Authority assumed responsibility for UWHC. However, during the first ten months of FY 2000-01, the Authority's "profit" was 4.9 percent of revenue, while its goal for the year is 4.0 percent.

Table 8

**The Authority's Revenue and Expenses**  
(in millions)

	<u>FY 1995-96*</u>	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>
Operating Revenue	\$300.3	\$313.1	\$329.2	\$355.9	\$392.8
Operating Expenses	<u>(292.7)</u>	<u>(306.4)</u>	<u>(322.1)</u>	<u>(352.0)</u>	<u>(395.0)</u>
Net Operating Income	7.6	6.7	7.1	3.9	(2.2)
Non-operating Revenue	<u>5.7</u>	<u>7.1</u>	<u>7.5</u>	<u>7.3</u>	<u>7.2</u>
Revenue in Excess of Expenses	\$ 13.3	\$ 13.8	\$ 14.6	\$ 11.2	\$ 5.0
"Profit" as a Percentage of Revenue	4.3%	4.3%	4.3%	3.1%	1.3%

\* Before June 29, 1996, UWHC operated as part of UW-Madison.

Although it is a nonprofit entity, the Authority must maintain sufficient resources to support a statutory mission that includes medical education, research, public service, and charity care. We note its ability to maintain resources is similar to that of other academic medical centers nationwide. The Council of Teaching Hospitals and Health Systems, which is part of an organization that represents more than 500 major teaching hospitals and medical schools, surveyed 103 academic medical centers and found that their median "profit" was 2.0 percent of operating revenue during FY 1998-99, the most recent year for which data are available.

Officials provided several reasons for the Authority's decline in profitability, including the opening of two outpatient clinics—UW Health-West in June 1999, and UW Health-East in November 1999—that involved large initial expenses officials believe will eventually be recouped. In early 2001, the two clinics were operating at only 40 percent of their capacities. Further, as already noted, Medicare and Medical Assistance reimbursements have not kept pace with inflation or cost increases. Staff salaries and the cost of drugs and other medical supplies have also increased significantly in recent years.

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**The Authority is working to increase its revenue.**

The additional \$3.2 million in Medicare funding that the Authority expects to receive in FY 2000-01 will help to ensure profitability. In addition, officials:

- increased the base hospital room and board rate for FY 2000-01 by 9.6 percent from the FY 1999-2000 rate (the daily room and board rates since the Authority's creation are listed in Appendix 4);
- implemented a plan to reduce projected FY 2000-01 costs by \$6.0 million by, for example, initiating drug cost-containment programs and reducing the costs of conducting medical tests; and
- are improving the accuracy of billing procedures to overcome past problems in realizing full reimbursement amounts in some instances.

As shown in Table 9, the Authority's total revenue increased from \$320.2 million in FY 1996-97 to \$400.0 million in FY 1999-2000, or by 24.9 percent. However, as shown in Table 10, expenses increased from \$306.4 million to \$395.0 million, or by 28.9 percent, during the same period. Purchased services expenses, which include expenses for contract nurses, increased 45.6 percent, while expenses for salaries and fringe benefits increased 25.7 percent. During the four-year period, the Authority's total expenses increased by 7.2 percent annually, on average.

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Table 9

**The Authority's Revenue**  
(in millions)

	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change</u>
Net Patient Service Revenue	\$306.1	\$321.6	\$347.7	\$384.3	25.5%
Other Operating Revenue	<u>7.0</u>	<u>7.6</u>	<u>8.2</u>	<u>8.5</u>	21.4
Operating Revenue	313.1	329.2	355.9	392.8	25.5
Non-operating Revenue	<u>7.1</u>	<u>7.5</u>	<u>7.3</u>	<u>7.2</u>	1.4
Total	\$320.2	\$336.7	\$363.2	\$400.0	24.9

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Table 10

**The Authority's Expenses**  
(in millions)

	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change</u>
Salaries	\$122.2	\$128.9	\$140.1	\$153.3	25.5%
Employee Fringe Benefits	<u>40.2</u>	<u>43.7</u>	<u>46.4</u>	<u>50.8</u>	26.4
Subtotal	162.4	172.6	186.5	204.1	25.7
Medical Supplies and Materials	57.8	60.8	69.4	80.0	38.4
Purchased Services*	34.0	37.9	43.2	49.5	45.6
Other Expenses**	26.3	25.8	27.9	29.9	13.7
Depreciation and Amortization	17.0	16.4	17.0	17.9	5.3
Bad Debt	6.5	6.0	5.5	9.9	52.3
Interest Expense	<u>2.4</u>	<u>2.6</u>	<u>2.5</u>	<u>3.7</u>	54.2
Total	\$306.4	\$322.1	\$352.0	\$395.0	28.9

\* Includes services provided by UW Medical School personnel and nurses hired from private firms, as well as laundry, snow removal, and groundskeeping services.

\*\* Includes repair and maintenance, utilities, malpractice insurance, and transportation.

Section 233.04(7m)(a), Wis. Stats., requires the Authority to retain cash reserves at or above a level recommended by an independent auditor, and the affiliation agreement requires the Authority to notify the Joint Committee on Finance if its cash reserves fall below the specified level on other than a short-term basis. Further, the covenants of the \$106.5 million in bonds that the Authority has issued to date require it to maintain 75 days' cash on hand. If it does not, it must hire a consultant to assess its cash flow situation and suggest ways to improve it. If the Authority had less than 45 days' cash on hand, the bonds would be in default.

The Authority's independent auditor has declined to recommend a specific cash reserves level, citing the difficulty of determining the Authority's future cash needs in an uncertain and changing health care environment. Instead, the auditor has encouraged the Authority to maintain cash reserves within a range that has as its minimum the

median number of days' cash held by hospitals with a credit rating of "A-," and as its maximum the median number of days' cash held by hospitals rated "AA." In 2000, this range was 213 days for hospitals rated "AA," and 117 days for hospitals rated "A-."

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**The Authority's cash reserves have generally been lower than those of similar hospitals.**

Authority officials have stated that they attempt to maintain cash reserves at the Standard & Poor's median for hospitals rated "A." As shown in Table 11, the Authority has been below its target since 1998. However, it has stayed within the range recommended by its independent auditor.

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Table 11

**The Authority's Cash Reserves**

	Number of Days of <u>Cash Reserves</u>	<u>Median*</u>	<u>Difference</u>
June 1996	138	n.a.	n.a.
June 1997	179	174	5
June 1998	164	189	(25)
June 1999	159	186	(27)
June 2000	142	162	(20)
April 2001	152	161	(9)

\* For hospitals rated "A" by Standard & Poor's.

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While the Authority's cash reserves are significantly greater than the 75-day minimum requirement in its bond covenants and are within the range suggested by its auditor, they have declined in three of the last four years. If cash reserves were to fall below the recommended range, the Authority's creditworthiness would be affected, which would in turn affect its ability to finance facility and equipment improvements.

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## Operating Trends

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**Operating trends have declined during the first ten months of FY 2000-01.**

During the Authority's first four years, various measures of operating performance, such as the number of inpatient admissions to UW Hospital, were positive. However, during the first ten months of FY 2000-01, the Authority did not meet its operating performance goals.

As shown in Table 12, annual inpatient admissions to UW Hospital increased from 19,247 in FY 1995-96 to 20,202 in FY 1999-2000, or by 5.0 percent from the year before the Authority's creation through its fourth year of operations. By April 2001, however, admissions had declined 2.6 percent from the same period in the prior fiscal year, and they were 6.6 percent less than budgeted.

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Table 12

### UW Hospital's Annual Inpatient Admissions

<u>Fiscal Year</u>	<u>Number</u>
1995-96	19,247
1996-97	20,319
1997-98	20,852
1998-99	21,039
1999-2000	20,202
2000-01*	16,439

\* Through April 2001

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The Authority competes locally, regionally, and nationally to provide inpatient services. Meriter Hospital and St. Marys Hospital, which are also located in Madison and provide general health care services, are the Authority's primary local competitors. Regional and out-of-state facilities such as the Marshfield Clinic and Mayo Clinic provide specialized inpatient services to those who might otherwise have been served by the Authority.

Authority officials had budgeted for a 3.0 percent increase in inpatient admissions in FY 2000-01, but they acknowledge that this goal will likely not be met. They attribute the decline, in part, to a nursing shortage that required the Authority to divert patients to Meriter and St. Marys hospitals. From October 1999 through November 2000, the

Authority diverted patients from UW Hospital intensive care units an average of 7.4 days per month, and from UW Hospital general care facilities an average of 4.5 days per month.

We compared inpatient information for UW Hospital with information for Meriter and St. Marys hospitals. Making comparisons is complicated because the Authority reports data on a fiscal year basis, and Meriter and St. Marys use a calendar year. Furthermore, UW Hospital generally admits more complex or difficult cases than the comparison hospitals do. However, from 1997 through 2000, total inpatient discharges at Meriter Hospital increased 9.3 percent, or from 14,158 to 15,471, while discharges at St. Marys increased 2.8 percent, or from 14,572 to 14,986. UW Hospital's discharge rate decreased 0.2 percent, or from 20,286 to 20,251 from FY 1996-97 through FY 1999-2000. Comparable data on admissions are not collected.

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**UW Hospital's occupancy rate is higher than those of two Madison hospitals.**

As shown in Table 13, inpatient occupancy rates at UW Hospital ranged from 71.7 percent to 76.4 percent during the Authority's first four years of operations. In comparison, Meriter Hospital had an occupancy rate of approximately 53 percent, and St. Marys had an occupancy rate of approximately 70 percent from 1997 through 1999. During the first ten months of FY 2000-01, UW Hospital's occupancy rate dropped to 69.3 percent, which was 9.1 percent lower than budgeted, as well as 8.2 percent lower than the occupancy rate during first ten months of the prior fiscal year.

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Table 13

**UW Hospital's Inpatient Occupancy Rate**

<u>Fiscal Year</u>	<u>Rate</u>
1995-96	72.9%
1996-97	72.2
1997-98	71.7
1998-99	76.4
1999-2000	75.4
2000-01*	69.3

\* Through April 2001.

As shown in Table 14, UW Hospital's average daily inpatient census remained relatively constant over a five-year period, decreasing from 350 in FY 1995-96 to 346 in FY 1999-2000. During the first ten months of FY 2000-01, however, the average daily census declined to 324, which was 11.0 percent lower than budgeted.

Table 14

**UW Hospital's Average Daily Inpatient Census**

<u>Fiscal Year</u>	<u>Average Number of Inpatients</u>
1995-96	350
1996-97	344
1997-98	337
1998-99	352
1999-2000	346
2000-01*	324

\* Through April 2001.

As noted, the Authority has undertaken an aggressive building program, including the construction of outpatient clinics and facilities that it reports will allow it to compete in the health care market. The proportion of the Authority's net patient service revenue arising from outpatient services increased from 28.7 percent in FY 1996-97 to 35.8 percent in FY 1999-2000.

**Visits to the Authority's outpatient clinics increased 29.2 percent since FY 1995-96.**

Annual outpatient visits to the Authority's clinics have increased 29.2 percent from their levels before the Authority was created. As shown in Table 15, 342,405 outpatients visited clinics in FY 1995-96, and 442,339 in FY 1999-2000. These data include outpatients at clinics within the Clinical Sciences Center and at other clinics the Authority owns directly, such as the UW Health-East and UW Health-West. However, outpatients at clinics owned by the UW Medical School, the UW Medical Foundation, or University Community Clinics, Inc., are not included in these data.

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Table 15

**Annual Visits to the Authority's Outpatient Clinics**

<u>Fiscal Year</u>	<u>Number</u>	<u>Percentage Change</u>
1995-96*	342,405	(2.0%)
1996-97	353,126	3.1
1997-98	379,997	7.6
1998-99	391,574	3.0
1999-2000	442,339	13.0
2000-01**	371,037	not applicable

\* Before June 29, 1996, UWHC operated as part of UW-Madison.

\*\* Through April 2001.

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While there have been mixed trends in the Authority's financial and operational performance during its first four years, officials believe overall performance will improve and that the Authority is well-positioned to compete in the health care market. Nevertheless, these mixed trends in financial and operational performance suggest that continued scrutiny by the Legislature may be warranted to ensure the Authority continues to meet its statutory mission.

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## The Authority's Mission

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**The Authority is generally fulfilling its statutory mission.**

In creating the Authority, the Legislature largely maintained UWHC's statutory mission. As set forth in s. 123.04(3b)(a), Wis. Stats., this mission is to deliver comprehensive, high-quality health care, including charity care to the indigent; provide a suitable environment for medical instruction; sponsor and support health care research; and conduct outreach activities that assist health programs and personnel throughout the state in the delivery of health care. The Authority is generally fulfilling its mission.

### Quality Health Care and Charity Care

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**The quality of health care that the Authority provides has received national recognition.**

UWHC had a long tradition of delivering comprehensive, high-quality health care, including charity care to the indigent, and a number of measures indicate that the Authority is maintaining the high level of service and the reputation of UWHC when it operated as part of UW-Madison. For example, the Authority was accredited by the Joint Commission on Accreditation of Healthcare Organizations, effective for three years beginning on August 21, 1999. The Authority had also been accredited by this organization for three years beginning on September 14, 1996. In addition, the Authority has received recognition regarding its provision of health care services in recent years in the national media. The July 17, 2000 edition of *U.S. News and World Report* ranked the top 50 hospitals in the nation in 16 medical specialties. The rankings were based on a survey of 150 board-certified specialists in each specialty and on mortality rates and other factors. As shown in Table 16, UW Hospital was ranked in 11 of 16 specialty areas. No other Wisconsin hospital was ranked in more than six specialties.

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Table 16

**UW Hospital's Rank in *U.S. News & World Report*,  
by Area of Medical Specialty**  
(Among the Top 50 U.S. Hospitals, as of July 2000)

<u>Medical Specialty</u>	<u>Rank</u>
Cancer	28
Digestive Disorders	24
Ear, Nose & Throat	25
Eyes	16
Heart	34
Hormonal Disorders	19
Kidney Disease	41
Orthopedics	26
Respiratory Disorders	27
Rheumatology	31
Urology	26

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UW Hospital was designated a Level I Trauma Center by the American College of Surgeons in 1998. It was the only such facility in Wisconsin outside of Milwaukee. In addition, according to the United Network of Organ Sharing, which maintains the nation's organ transplant waiting list, the Authority's transplant program was the nation's second-largest in 1999. Finally, patient satisfaction surveys conducted from September 1999 through November 2000 by an outside firm under contract with the Authority rank UW Hospital in the top one-third of academic medical centers in adult inpatient satisfaction with health care services received.

To help fulfill its mission to provide health care to the indigent, the Authority reduces or forgives entirely the cost of medical services to certain qualified individuals. Officials have been following the same policies and procedures regarding what is commonly referred to as charity care since before the Authority's creation. To be eligible, a patient's income must generally be less than 200 percent of the federal poverty level, and the patient may not be covered by insurance or a government program. Overall, staff exercise a certain amount of judgment when deciding eligibility, which typically occurs after a patient has received health care services.

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**The Authority provided \$7.3 million of charity care in FY 1999-2000.**

As shown in Table 17, the amount of charity care provided by the Authority increased from \$6.3 million in FY 1995-96 to \$7.3 million in FY 1999-2000, or by 15.9 percent. From FY 1996-97 through FY 1999-2000, charity care under the Authority remained relatively consistent as a proportion of gross patient revenue, although it declined somewhat in FY 1999-2000.

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Table 17

**The Authority's Charity Care**

<u>Fiscal Year</u>	<u>Charity Care</u>	<u>Charity Care as a Percentage of Gross Patient Revenue</u>
1995-96	\$6,254,220	1.7%
1996-97	5,874,576	1.5
1997-98	6,002,387	1.5
1998-99	7,817,699	1.7
1999-2000	7,279,810	1.3

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A large share of charity care in the state is provided by relatively few hospitals. In FY 1998-99, the most recent year for which data are available, 19 hospitals provided \$78.1 million of charity care, or 66.8 percent of the total provided by all Wisconsin hospitals. From FY 1996-97 through FY 1998-99, the Authority was among the top three providers in Wisconsin, along with St. Luke's Medical Center and Froedtert Memorial Lutheran Hospital, which are both located in Milwaukee.

As shown in Table 18, the Authority devoted a similar proportion of its gross patient revenue to charity care in recent years as 12 large Wisconsin hospitals did, including 2 that are also located in Madison. Charity care for all Wisconsin hospitals averaged 1.2 percent of gross patient revenue in both FY 1996-97 and FY 1997-98, and 1.1 percent in FY 1998-99.

Table 18

**Charity Care as a Proportion of Gross Patient Revenue**

	<u>City</u>	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>
<b>The Authority</b>	<b>Madison</b>	<b>1.5%</b>	<b>1.5%</b>	<b>1.7%</b>
Beloit Memorial Hospital	Beloit	2.8	3.8	3.7
Froedtert Memorial Lutheran Hospital	Milwaukee	1.8	2.0	1.5
Mercy Health Systems	Janesville	2.1	1.2	1.6
Meriter Hospital	Madison	1.1	1.0	0.8
Saint Joseph's Hospital	Milwaukee	1.7	1.6	1.4
St. Luke's Medical Center	Milwaukee	1.4	1.3	1.2
St. Mary's Hospital	Milwaukee	1.6	1.7	1.4
St. Marys Hospital Medical Center	Madison	1.1	1.1	1.6
St. Michael Hospital	Milwaukee	1.5	1.8	1.9
St. Vincent Hospital	Green Bay	1.7	2.2	2.3
Sinai Samaritan Medical Center	Milwaukee	1.8	1.8	1.0
Waukesha Memorial	Waukesha	1.2	1.2	1.0

Even if the Authority provides charity care for hospital charges, patients do not automatically receive charity care for the physicians' charges. As noted, the UW Medical Foundation bills patients for physician charges incurred while receiving medical services at UW Hospital and the clinics in the Clinical Sciences Center. Its procedures for providing charity care are similar, but not identical, to the Authority's procedures, and both sets of procedures require subjective judgment. Therefore, a patient could receive charity care from the Authority but not the UW Medical Foundation. Authority officials indicate they are developing policies and procedures to coordinate their charity care procedures with the UW Medical Foundation's procedures.

**Supporting Medical Education**

**UW-Madison officials are satisfied with the Authority's support for medical education.**

UW Hospital has been a setting for instructing medical professionals since 1924. The Authority has maintained, and in some cases increased, its financial support for UW-Madison medical education. The deans of the UW Medical School, the UW School of Nursing, and the UW School of Pharmacy indicated their satisfaction with the level of financial support that their schools have received from the Authority.

The affiliation agreement requires the Authority to base its financial support of UW-Madison medical education and clinical programs on FY 1994-95 funding levels, adjusted for annual faculty salary increases. This support includes:

- annual direct transfers to Center for Health Sciences programs, which include the UW Medical School; the UW School of Nursing; the UW School of Pharmacy; the Human Subjects Committee, which ensures that research is done in accordance with ethical principles and applicable regulations; and the Center for Health Sciences Library;
- annual expenditures for graduate medical education, nursing education, pharmacy residency, and other health programs;
- capital expenditures on behalf of the UW Medical School;
- support for the lease of sites that house UW Medical School activities; and
- annual indirect support for UW School of Nursing programs and clinical activities of UW Medical School faculty.

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**Direct transfers in support of medical education increased 23.9 percent from FY 1996-97 through FY 1999-2000.**

The affiliation agreement requires direct transfers to the Center for Health Sciences programs to be adjusted annually, from a base of \$11.1 million in FY 1994-95, based on increases in faculty, academic staff, and classified salaries or other relevant increases. In addition, use of these funds is to be determined annually through a collaborative planning process involving the Authority and the Center for Health Sciences programs. The UW Medical School uses direct transfers to fund faculty salaries for teaching and administrative services, but not for patient care. Available information indicates the Authority's direct transfers to Center for Health Sciences programs increased 23.9 percent from FY 1996-97 through FY 1999-2000, as shown in Table 19. In comparison, UW-Madison faculty salaries increased 19.5 percent during the same period.

Table 19

**Direct Transfers from the Authority to Center for Health Sciences Programs**

<u>Center for Health Sciences Program</u>	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change</u>
UW Medical School	\$12,617,437	\$13,346,263	\$14,938,312	\$15,675,076	24.2%
UW School of Pharmacy	224,000	228,400	231,258	270,270	20.7
UW School of Nursing	209,690	205,125	226,804	231,258	10.3
Center for Health Sciences Library	65,000	80,000	80,000	80,000	23.1
Human Subjects Committee	<u>21,444</u>	<u>21,444</u>	<u>21,444</u>	<u>21,444</u>	0.0
Total	\$13,137,571	\$13,881,232	\$15,497,818	\$16,278,048	23.9

The direct transfer amounts are negotiated in detail, often in terms of individual employees, and are documented in a base bill that is often not completed until after the fiscal year, at which time there is a final determination of the level of funding the Authority provided. However, it should be noted that the Authority was unable to reconcile base bill information to its accounting records for the UW School of Nursing and the UW School of Pharmacy. Consequently, although the amounts in Table 19 are the best available information, they can be considered only estimates.

The affiliation agreement also established a base level of support for direct expenditures for graduate medical education, nursing education, pharmacy residency, and other health programs administered by the Authority. Graduate medical education was the responsibility of UWHC before the Authority's creation, and the affiliation agreement established that the Authority would continue to fulfill this obligation.

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**Support for graduate medical education increased 15.3 percent in recent years.**

Support for graduate medical education in the FY 1994-95 base year was \$12.5 million. As shown in Table 20, the amount spent on graduate medical education increased 15.3 percent from FY 1996-97 through FY 1999-2000.

Table 20

**Graduate Medical Education Costs Funded by the Authority**

<u>Type of Education</u>	<u>FY 1996-97</u>	<u>FY 1997-98</u>	<u>FY 1998-99</u>	<u>FY 1999-2000</u>	<u>Percentage Change</u>
Intern and Resident	\$11,914,814	\$12,074,260	\$13,015,901	\$13,604,824	14.2%
Paramedical	<u>798,757</u>	<u>973,474</u>	<u>930,821</u>	<u>1,056,273</u>	32.2
Total	\$12,713,571	\$13,047,734	\$13,946,722	\$14,661,097	15.3

Under the affiliation agreement, the Authority also agreed to support \$6.0 million in UW Medical School capital expenditures at the Clinical Sciences Center, and it transferred \$6.3 million in three installments from FY 1998-99 through FY 2000-01. These amounts are included in the payments that were shown in Table 2. In addition, the Authority pledged to provide annual lease payments to the UW Medical School for property in University Research Park that is used by the Authority's Sports Medicine Clinic. It has paid \$79,864 annually since FY 1996-97 to meet this obligation. These amounts are also included in Table 2.

Finally, the affiliation agreement estimated that UWHC provided \$509,500 in annual indirect support for UW School of Nursing programs and \$8.4 million in annual indirect support for UW Medical School physician faculty during FY 1994-95, and the agreement requires the Authority to maintain this level of support. Indirect support is not considered a monetary transfer, but rather an estimate of the value of the time spent by hospital and clinic staff who provide services in support of those schools. For example, hospital nursing staff help teach undergraduate and graduate students from the UW School of Nursing. Additionally, a number of hospital departments, such as information systems, medical records, and patient registration, provide clinical support to UW Medical School physicians.

The Authority has not analyzed the level of indirect support that it currently provides, so we were unable to determine the amount. However, the deans of the UW School of Nursing, the UW School of Pharmacy, and the UW Medical School stated that they are satisfied with the monetary and non-monetary support their schools have received from the Authority, and they believe this support is the same or greater than it was before the Authority was created.

## Support of Research

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**Support for medical research has been maintained.**

The third part of the Authority's mission is to sponsor and support research in the delivery of health care that improves the welfare of patients and facilitates advances in knowledge that alleviate human suffering, promote health, and prevent diseases. Officials indicated that the Authority has maintained the same level of research support that existed before its creation.

The Authority does not provide a significant amount of direct funding for health care research, but it does provide the space and services necessary to carry out such research. The exact level of support for research is not tracked, but one example of the types of research in which the Authority is involved is its operation of a general clinical research center where medical research funded by the National Science Foundation is conducted. In addition, the Authority conducts research to prevent eye diseases that afflict the elderly, determine the factors that lead to asthma, and study athletes' body composition. The UW Health-West Clinic houses the Women's Health Initiative, where research on breast cancer and osteoporosis is performed.

Medical professionals at UWHC also conduct clinical trials of new drugs, technology, and procedures. Recent examples include:

- cancer drugs aimed at killing tumors;
- new breast cancer and osteoporosis drugs;
- a pediatric cardiology exercise program;
- a drug to immunize against urinary tract infections;
- the use of radiotherapy on patients who have undergone angioplasty; and
- a drug for aggressive treatment of heart attacks.

## Outreach Activities

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**The Authority is fulfilling its mission of supporting outreach activities.**

The fourth part of the Authority's mission is to assist health programs and personnel throughout the state and region in the delivery of health care. Although we were unable to quantify the value of outreach activities that occur or to determine whether these activities have increased since the June 1996 restructuring, officials believe the Authority is at least maintaining its outreach efforts.

Various departments of the Authority engage in outreach activities, including the Department of Outreach Education, the Public Affairs Department, and many Center for Health Sciences programs. While some activities are coordinated with the Department of Outreach Education, many are provided directly by individual hospital departments.

As shown in Table 21, annual expenditures for the Department of Outreach Education were relatively stable during the Authority's first four years. The Department produces a quarterly publication, *Health Bound*, that provides wellness information, describes various health and fitness classes and support groups, and includes information on how schools or organizations can schedule medical professionals to discuss health-related topics. The Department also produces a half-hour weekly video program, *Picture of Health*, that discusses health issues and is shown on public access television stations throughout the state. The Department of Outreach Education employs three full-time employees to produce these programs, which are created and presented by medical faculty and staff.

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Table 21

**Department of Outreach Education Expenditures**

<u>Fiscal Year</u>	<u>Amount</u>
1996-97	\$393,139
1997-98	420,689
1998-99	417,973
1999-2000	406,932

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The Public Affairs Department, which is jointly funded by the Authority and the UW Medical School, is engaged in marketing and public relations activities, such as coordinating health-related interviews between members of the media and medical professionals. It arranged 386 interviews during 2000, and every six weeks it produces health-related videos that are sent to television stations throughout the state. Each video contains four stories and an introductory script that can be used as part of the stations' news broadcasts. A recent video included stories on an asthma study, a new cancer drug, paintball injuries, and the

Wisconsin Alzheimer's Foundation. The Public Affairs Department also sponsors health and safety activities and publishes several newsletters. Authority officials estimate that the Public Affairs Department spent \$390,000 on outreach activities in FY 1999-2000.

University Health Care, which negotiates contracts for the provision of hospital and physician services for the Authority and the UW Medical Foundation, also conducts outreach activities. It has an arrangement with 22 Wisconsin hospitals to provide their medical staffs with continuing medical education. From June 1, 1998 through November 20, 2000, 251 continuing medical education courses were presented through this process. In addition, University Health Care contracts with 38 regional clinics to provide allergy, plastic surgery, pediatric cardiology, and other specialty services to under-served communities.

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**UWHC officials believed excessive oversight had hindered their flexibility before 1996.**

In advocating for the Authority's creation, UWHC officials had contended that hospital operations were often constrained by excessive oversight, and they cited specific concerns related to capital acquisition, personnel, and purchasing. Authority officials believe their flexibility in these areas has been enhanced considerably as a result of the Authority's creation, but information is not available to quantify the savings and other benefits that resulted from the restructuring. It appears the greatest increases in flexibility have been in capital acquisition and personnel, although many of the efficiencies achieved in purchasing likely would have been possible even if the Authority had not been created.

### **Capital Acquisition**

Capital acquisition procedures have changed considerably since the Authority's creation. When UWHC operated as part of UW-Madison, its construction and improvement projects required the review and approval of UW-Madison, UW System Administration, the Department of Administration, and the State Building Commission. The Authority, however, has wide latitude to plan and carry out capital building projects, although it is subject to a \$106.5 million statutory bonding limit. The Governor's 2001-03 Biennial Budget Proposal recommends increasing this amount to \$175.0 million.

In the early 1990s, UWHC officials asserted that a significant reason to restructure UWHC as a public authority was to increase its flexibility to complete construction and improvement projects. As a state agency, UWHC was subject to statutory requirements that:

- allowed the Department of Administration's Division of Facilities Development to decide whether bids would be solicited for projects costing between \$30,000 and \$99,999;
- provided that the Division of Facilities Development would oversee construction and improvement projects costing between \$100,000 and \$250,000, and required UWHC to submit such projects to the State Building Commission for approval; and

- required projects costing more than \$250,000—an amount that was increased to \$500,000 in July 1997—to be enumerated in session law as part of the State’s capital budget.

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**Approval for construction projects changed considerably when the Authority was created.**

The Authority’s creation reduced the amount of outside approval that officials were required to obtain in order to initiate construction and improvement projects, and it resulted in increased flexibility to complete larger projects. The 1996 lease between the Authority and the Board of Regents requires UW-Madison’s Chancellor and the Board of Regents to approve projects on state property that exceed a specified threshold, which was initially set at \$250,000 and is adjusted annually for inflation. The threshold has been \$277,800 in FY 2000-2001. In addition, the Authority must seek UW-Madison’s review and approval for all projects that affect the hospital’s skyline, exterior, or site. The lease also requires the Authority and UW-Madison to exchange annual reports of all projects that affect the hospital, although it appears neither party has prepared such reports.

Section 16.85(14), Wis. Stats., requires the Division of Facilities Development to ensure that projects on state-owned land that exceed the threshold meet state specifications and minimum design standards, to approve the Authority’s decision to proceed with construction, and to review progress after construction has begun. While one of the Division’s project managers reviews the plans and specifications for the Authority’s projects, the Division does not have a formal process by which it approves the Authority’s decision to proceed with construction. In addition, officials in the Division have asked the Authority to review progress after construction begins, because the Division does not negotiate or sign contracts for the Authority’s projects or perform typical construction administration.

The Authority has written policies and procedures for selecting architectural and engineering services and for awarding construction contracts. As part of the Authority’s review and approval process, hospital departments identify projects they would like funded. Projects costing less than \$100,000 are funded at the discretion of the Authority’s chief executive officer, but projects costing more than \$100,000 are subject to an internal review and approval process in which:

- the Authority’s Capital Allocation Committee makes a preliminary determination of which projects to fund;
- the Authority’s chief executive officer and chief financial officer determine project priorities and itemize projects in a fiscal year capital budget; and

- the Authority's board of directors reviews and approves the capital budget.

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**The Authority has completed 109 construction and improvement projects since FY 1996-97.**

The Authority completed 109 construction and improvement projects on state-owned land from FY 1996-97 through FY 1999-2000, including 6 projects that exceeded the \$250,000 threshold. These six projects accounted for approximately \$7.5 million of the \$11.6 million spent on all projects, or 64.3 percent. The other projects were typically minor space improvements or modifications. Because the majority of the Authority's projects on state-owned land were relatively minor, they would have been subject to minimal external review even if the restructuring had not occurred. However, the Authority likely benefited considerably from its flexibility to complete projects costing between \$100,000 and \$250,000 on state-owned land, as well as projects on land it owned regardless of project costs.

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**Large construction projects now take the Authority less time to complete.**

Authority officials stated that before the restructuring, projects costing more than \$250,000 typically took six to eight years to complete because of the various external reviews and approvals required. Currently, however, large-scale projects on the Authority's property, as opposed to the State's, are not subject to review by the Board of Regents or the Department of Administration. Authority officials noted that construction of the UW Health-West Clinic, undertaken after the Authority's creation and on land owned by the Authority, was planned, approved, and completed in about 3.5 years. They asserted that costs were reduced because building materials were not subject to added years' inflation and that the project design did not need to be modified as specifications changed over time.

The Authority has likely benefited from increased flexibility in other areas as well. For example, officials stated that restructuring allows a design-build approach, under which the Authority signs one contract with designers, architects, engineers, and contractors who work cooperatively. More typically, state agencies let individual contracts sequentially for design and construction. To use the design-build approach, state agencies must work with the Division of Facilities Development to determine whether the approach will be advantageous for a specific project, and then receive permission from the Building Commission before proceeding. Authority officials stated the design-build approach was used for construction of the UW Health-West Clinic, and they believe the construction process for this facility was more effective than the simultaneous construction of the UW Health-East Clinic, for which multiple contracts were signed.

In addition, officials stated that before the Authority's creation, they typically used a model construction contract designed by the American Institute of Architects. They indicated that this contract sometimes made it difficult to require contractors to rectify design or construction errors

at their own expense, and that resolution of such errors was sometimes costly for UWHC. Since the Authority's creation, however, it has commissioned and typically uses a different model contract that holds contractors financially responsible for design or construction errors. Authority officials are satisfied with this new model contract, although specific savings accrued as a result of its use have not been calculated.

## Personnel

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**Authority officials believe they have improved their personnel functions.**

Before June 1996, UWHC followed state rules for personnel recruitment; assigning employees to specific classifications; setting compensation levels; and guaranteeing employees' rights regarding layoffs, transfers, and reinstatements. UWHC officials asserted that operating a large academic medical center presented staffing challenges not typically faced by other state agencies and, as a result, the State's personnel policies and procedures were not effective for UWHC. When the Authority was created, it assumed many personnel functions that officials believe they have been able to improve.

The Authority directly employs most hospital and clinic staff, including nurses, who participate in the Wisconsin Retirement System but who are not in the state classified or civil service. However, 1,917 blue-collar, technical, and administrative staff, such as custodians, respiratory therapists, and medical transcriptionists, remained state employees as of March 2001, and they are employed by the UW Hospitals and Clinics Board. The Authority executed a contractual services agreement with the Board for the services of these employees. The Department of Employment Relations contractually delegated responsibility for their recruitment, selection, classification, and supervision to the Board, which in turn delegated the responsibility to the Authority under the contractual services agreement.

In FY 2000-01, the Board will receive its entire budget of \$67.5 million from the Authority. Authority officials stated that the Board has increased its staff considerably since July 1998, largely as a result of opening the UW Health-East and UW Health-West clinics. The Governor's 2001-03 Biennial Budget Proposal recommends that \$79.5 million in program revenue be transferred from the Authority to the Board in FY 2001-02, which is a 17.8 percent increase that takes into account recent staffing increases, and that \$82.7 million in program revenue be transferred in FY 2002-03, which is an additional 4.0 percent increase.

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**Staffing increased to 4,263 FTE positions in September 2000.**

Table 22 shows changes in the number of UW Hospital and Clinics FTE staff positions, including those at the Authority and the Board, from September 1997 through September 2000. Total staffing increased 12.1 percent, from 3,803 FTE positions to 4,263 FTE positions, over that four-year period.

Table 22

**UW Hospital and Clinics FTE Staff Positions,  
by Occupational Area**  
(As of September 30)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>Percentage Change</u>
Administrators	41	38	36	32	(22.0%)
Pharmacy	141	139	155	167	18.4
Radiology	127	137	142	175	37.8
Clinical Laboratory	188	193	203	202	7.4
Other Nursing*	356	405	391	362	1.7
Residents	432	436	436	444	2.8
Other Technical**	587	595	618	747	27.3
Registered Nurses	865	875	953	952	10.1
Non-medical Personnel***	<u>1,066</u>	<u>1,134</u>	<u>1,277</u>	<u>1,182</u>	10.9
Total	3,803	3,952	4,211	4,263	12.1

\* Includes licensed practical nurses, nurse midwives, nurse practitioners, and ancillary nursing personnel.

\*\* Includes physician assistants, dieticians, physical therapists, occupational therapists, and phlebotomists.

\*\*\* Includes clerical and custodial staff, facilities workers, and food service workers.

As shown in Table 23, 797 physicians practiced in support of the Authority's mission on May 4, 2001. This includes UW Medical School faculty who practice in the Clinical Sciences Center and at the Authority's outpatient clinics, such as UW-Health East and UW-Health West.

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Table 23

**Physicians at the Authority**  
As of May 4, 2001

<u>Department</u>	<u>Number</u>
Medicine	245
Surgery	104
Pediatrics	90
Family Medicine	77
Radiology	60
Anesthesiology	47
Psychiatry	43
Ophthalmology	33
Neurology	24
Pathology	24
Obstetrics/Gynecology	23
Human Oncology	10
Rehabilitation Medicine	9
Neurosurgery	<u>8</u>
Total	797

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The Authority's creation has addressed several personnel concerns that UWHC officials had raised. First, officials had believed that they did not have significant involvement in the collective bargaining process. The Authority now bargains separately with the four unions that represent staff of the Authority and the UW Hospitals and Clinics Board. As a result, officials believe that they are now better able to address important issues unique to the Authority's operations and that they can avoid bargaining on issues that do not affect the Authority.

Second, UWHC officials had expressed concern that adhering to the State's hiring process sometimes prevented them from filling positions in a timely manner. Authority officials believe they are now better able to recruit staff because positions employed by the Authority are no longer subject to Department of Employment Relations rules. In addition, the contractual services and delegation agreements give the Authority responsibility for hiring and classifying most UW Hospitals and Clinics Board employees. Although Department of Employment Relations officials indicated that staffing functions could have been

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delegated to UWHC, UW System Administration had not requested the authority necessary to do so.

Third, UWHC officials had asserted that existing state job classifications hindered them from hiring in the particular skill areas they needed. Since the Authority's creation, however, the contractual services and delegation agreements have allowed the Authority to revise the titles and job descriptions of numerous classifications to reflect specific hospital duties.

UWHC officials had also cited other concerns about the State's personnel processes. For example, they had asserted that, as a state agency, it was sometimes difficult to offer competitive salaries. However, in 1994 (report 94-5), we concluded that compensation for UWHC positions was typically competitive. UWHC officials had also indicated that they were sometimes unable to hire experienced individuals at rates higher than the base wage rate typically offered by state agencies. Although state agencies were able to hire above the base wage rate before the Authority's creation, and UWHC did so when hiring certain nurses, physical therapists, and administrative assistants, it was likely more difficult to do so at that time.

### **Nursing Issues**

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**The Authority has had difficulty employing a sufficient number of nurses.**

The Authority was able to promptly negotiate three of its four union contracts for 2001-2003, but negotiations for the nurses' contract have been protracted, and the nurses' union filed an unfair labor practices complaint with the Wisconsin Employment Relations Commission on May 15, 2001. While issues between the Authority and the nurses' union are complex, many appear to be influenced by the difficulty the Authority has had in employing and retaining a sufficient number of nurses, especially inpatient nurses.

Authority and union officials have separately indicated that currently, salaries are generally competitive overall, and recruitment and retention difficulties are caused, in part, by a general shortage of nurses nationwide. Nevertheless, there are additional issues that contribute to higher nurse vacancy rates at the Authority than at surrounding hospitals. For example, insufficient employee parking at the Clinical Sciences Center has often been cited as a hindrance to recruitment and retention. In addition, while nurses are no longer state employees, they have retained their participation in the Wisconsin Retirement System, and like classified state employees they must pay the entire cost of their health insurance during the first six months of employment. Surrounding hospitals provide subsidized health insurance for nurses immediately.

Union officials also cited the greater use of forced overtime at the Authority, compared to a nearby hospital, as a factor contributing to retention difficulties. Nurses' union data, which we adjusted to reflect differences in staff sizes, indicate that in 2000, the Authority required extra shifts four times more often than extra shifts were required by Meriter Hospital. The Authority indicates that its nurses worked 2,598 mandated extra shifts in 2000, which is an average of 3.35 mandated extra shifts per nurse. It should be noted that because some hospital and clinic units may require mandated overtime more frequently than others, the experience of an individual nurse may vary considerably from the average. For example, information from the Authority indicates that 12 percent of nurses had six or more mandated shifts in the prior 12 months, while 88 percent had five such shifts or less.

Authority officials indicate they are continuing to take steps to lower their nurse vacancy rate, which should reduce the need for mandatory extra shifts. The vacancy rate has declined from 21.0 percent in July 2000 to 11.6 percent in May 2001. Nevertheless, officials indicate that because of the Authority's large number of specialty beds, they need to recruit relatively larger numbers of nurses with specialized training than surrounding hospitals do. Consequently, recruitment and retention will continue to be challenging.

### **Purchasing**

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**UWHC officials were frustrated with state purchasing requirements before 1996.**

UWHC officials believed state purchasing requirements were burdensome and often resulted in unnecessary costs and delays in their operations. Authority officials believe that they have been able to reduce costs and to sign contracts that better serve their needs. While it appears that the Authority has achieved purchasing efficiencies, the savings have not been quantified, and in many instances it is unclear whether the improvements can be attributed to increased flexibility.

Since the restructuring, the Authority has established purchasing policies that officials indicate are consistent in principle with the state procurement manual, particularly with respect to competitive bidding. However, they assert that they have improved the purchasing process by simplification and the incorporation of key concepts such as contract performance requirements.

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**As of February 2001, the Authority had 1,450 separate contracts for the goods and services it purchases.**

As of February 2001, the Authority had 1,450 separate contracts for the goods and services it purchases. Under the operating and services agreement, the Authority can purchase goods and services through UW-Madison, UW System Administration, Board of Regents, and Department of Administration contracts. As of January 2001, the Authority was using 37 university and 17 state contracts to purchase

computer equipment, cellular telephone service, elevator maintenance, and other goods and services.

In addition, the Authority is affiliated with Novation, a group purchasing organization that includes approximately 1,400 health care facilities nationwide and uses bulk purchasing to secure favorable prices from vendors. The Authority currently participates in approximately 200 contracts for medical and surgical supplies through Novation, as well as about 150 pharmaceutical contracts. Finally, the Authority may enter into contracts directly with vendors, independent of other entities or purchasing arrangements. The Authority currently participates in about 1,050 such contracts.

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**The amount that the Authority's purchasing arrangements has saved is unknown.**

It is not possible to determine the savings that have resulted from particular contracts into which the Authority has entered. Authority officials assert that, compared to the next-lowest cost contracts available, their participation in Novation contracts results in average annual savings of about 2 percent for medical and surgical supplies and about 3 to 5 percent for pharmaceuticals. However, UWHC had obtained a waiver from the Department of Administration that allowed it to participate in approximately 100 contracts through a group purchasing organization that predated Novation. As a result, it is unclear which Novation contracts UWHC could have participated in if the Authority had not been created, or whether it could have realized savings from them.

Officials cited two examples of the Authority having simplified its purchasing process:

- Before 1998, the Authority purchased supplies for about 1,000 cardiac catheterization procedures performed annually and stored them until needed. Physicians frequently required multiple supplies to complete a single procedure, given the complexity of the cases treated, and the average cost per procedure exceeded \$3,500. In 1998, the Authority entered into a contract for these supplies that has several advantages. The new contract increased the Authority's bargaining power by reducing the number of primary suppliers from four to one. It also decreased inventory costs by allowing the Authority to order and stock supplies, but to not purchase them until used, which resulted in a one-time savings of \$250,000. Finally, the contract reduced costs by \$1,125 per procedure—or \$1.1 million annually—by establishing a per procedure price, rather than a per item price.

- UWHC officials purchased custom administrative forms every six months, and they stored and distributed the forms to hospital departments as needed. In October 1996, the Authority began to use the Internet to order certain forms and print them where and when they were needed. This practice has since expanded and has allowed the Authority to reduce its inventory of forms and the number of obsolete forms; update custom forms quickly and efficiently; and print clinic forms when patients arrive and with the patients' demographic information already encoded, which saves time and reduces transcription errors. Authority officials estimated that this arrangement saved more than \$200,000 in the first year after its implementation and resulted in a 29 percent reduction in annual expenditures for forms.

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**Some purchasing improvements could have been achieved even under state guidelines.**

While these examples demonstrate effective contract management, officials acknowledged that the contracts could have been structured in this manner regardless of the Authority's status as a public entity, either within state purchasing guidelines or with waivers from the Department of Administration. Authority officials also believe that the amount of time necessary to purchase items has declined. However, it was not possible to verify this because comparable data for the Authority and state agencies are unavailable.

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## Appendix 1

### **Membership of the Authority's Board of Directors**

Five ex officio members:

- Joint Committee on Finance Senate co-chair
- Joint Committee on Finance Assembly co-chair
- UW-Madison Chancellor
- UW-Madison Medical School Dean
- Secretary of the Department of Administration

Three members nominated by the Governor, with the Senate's approval

Three members of the University of Wisconsin Board of Regents, appointed by the president of the Board of Regents

One chairperson of a department at the UW-Madison Medical School, appointed by the UW-Madison Chancellor

One faculty member of a UW-Madison health professions school, other than the UW-Madison Medical School, appointed by the UW-Madison chancellor

Two nonvoting labor organization representatives, appointed by the Governor



## Appendix 2

### **UW Health Clinics**

#### **Authority**

UW Health-Dental Clinic  
UW Health-East Clinic  
UW Health-East Dialysis  
UW Health-Oakwood Village Clinic  
UW Health-Research Park (Sports Medicine Clinic)  
UW Health-University Station, Internal Medicine  
UW Health-Waisman Clinic  
UW Health-West Clinic

#### **UW Medical School-Department of Family Medicine**

UW Health-Belleville Family Medical Clinic  
UW Health-Eau Claire Family Medicine Clinic  
UW Health-Fox Valley Family Practice Clinic  
UW Health-Northeast Family Medical Center  
UW Health-Research Park Family Medicine Clinic  
UW Health-Verona Family Medical Clinic  
UW Health-Wausau Family Practice Clinic  
UW Health-Wingra Family Medical Center

#### **UW Medical School-Department of Psychiatry**

UW Health-Psychiatry Clinics

#### **University Community Clinics, Inc.**

UW Health-Beaver Dam Community Clinic Internal Medicine  
UW Health-Beaver Dam Community Clinic Warren Street  
UW Health-Cottage Grove Community Clinic  
UW Health-Crossroads Community Clinic  
UW Health-Horicon Clinic  
UW Health-Mazomanie Community Clinic  
UW Health-Portage Community Clinic  
UW Health-Stoughton Clinic  
Gateway Madison  
Gateway Stoughton

## **UW Medical Foundation**

UW Health-University Physicians at the General Pediatric and Teenage Clinics

UW Health-Physicians Plus 20 South Park Street

UW Health-Physicians Plus Columbus

UW Health-Physicians Plus Cross Plains

UW Health-Physicians Plus DeForest

UW Health-Physicians Plus East Towne

UW Health-Physicians Plus Fitchburg

UW Health-Physicians Plus Fort Atkinson

UW Health-Physicians Plus McFarland

UW Health-Physicians Plus Meadowood

UW Health-Physicians Plus Middleton

UW Health-Physicians Plus Monona

UW Health-Physicians Plus Mount Horeb

UW Health-Physicians Plus Odana

UW Health-Physicians Plus Oregon

UW Health-Physicians Plus Palmyra Eagle

UW Health-Physicians Plus Sun Prairie

UW Health-Physicians Plus Verona

UW Health-Physicians Plus Waterloo

UW Health-Physicians Plus Waunakee

UW Health-Physicians Plus West Towne

Appendix 3

**Debt Service on Revenue Bonds and Lease Payments**

<u>Year</u> <sup>1</sup>	<u>Debt Service for Leased Space (Assumed Debt)</u>	<u>Debt Service on 1997 Series Bonds</u> <sup>2</sup>	<u>Debt Service on 2000 Series Bonds</u> <sup>3</sup>	<u>Total Debt Service</u> <sup>4</sup>
1997	\$ 3,997,352	\$ 423,904	----	\$ 4,421,256
1998	4,042,858	1,803,630	----	5,846,488
1999	3,992,269	1,596,095	----	5,588,364
2000	3,961,449	1,879,973	\$ 931,820	6,773,242
2001	3,995,294	1,925,579	3,511,839	9,432,712
2002	4,585,147	1,930,000	3,435,495	9,950,642
2003	4,153,162	1,930,000	3,435,495	9,518,657
2004	4,135,499	1,934,421	3,435,495	9,505,415
2005	3,815,757	1,925,579	3,435,495	9,176,831
2006	3,829,452	1,930,000	3,435,495	9,194,947
2007	3,071,592	1,930,000	4,015,495	9,017,087
2008	2,735,581	1,934,421	4,349,465	9,019,467
2009	2,536,606	1,925,579	4,553,435	9,015,620
2010	2,185,511	2,230,000	4,603,035	9,018,546
2011	2,000,917	2,418,420	4,600,710	9,020,047
2012	1,837,613	2,603,470	4,578,150	9,019,233
2013	1,430,897	2,967,812	4,621,070	9,019,779
2014	709,882	3,729,640	4,575,300	9,014,822
2015	287,346	4,156,300	4,571,115	9,014,761
2016	81,845	4,467,471	4,466,990	9,016,306
2017	0	4,652,017	4,362,865	9,014,882
2018	0	4,635,920	4,383,740	9,019,660
2019	0	4,712,400	4,301,959	9,014,359
2020	0	4,783,866	4,233,340	9,017,206
2021	0	4,939,813	4,076,965	9,016,778
2022	0	4,991,660	4,023,040	9,014,700
2023	0	5,033,400	3,984,000	9,017,400
2024	0	5,168,720	3,850,000	9,018,720
2025	0	5,288,967	3,726,620	9,015,587

<u>Year</u> <sup>1</sup>	<u>Debt Service for Leased Space (Assumed Debt)</u>	<u>Debt Service on 1997 Series Bonds</u> <sup>2</sup>	<u>Debt Service on 2000 Series Bonds</u> <sup>3</sup>	<u>Total Debt Service</u> <sup>4</sup>
2026	\$ 0	\$ 5,400,720	\$ 3,618,240	\$ 9,018,960
2027	0	0	9,018,930	9,018,930
2028	0	0	9,017,070	9,017,070
2029	<u>0</u>	<u>0</u>	<u>9,016,380</u>	<u>9,016,380</u>
Total	\$57,386,029	\$95,249,777	\$134,169,048	\$286,804,854

<sup>1</sup> Amounts for 1997 through 2000 reflect actual payments.

<sup>2</sup> Original principal amount of \$50.0 million.

<sup>3</sup> Original principal amount of \$56.5 million.

<sup>4</sup> Includes \$146,339,443 million in principal and \$140,465,411 in interest costs.

Appendix 4

**The Authority's Daily Hospital Room and Board Rates\***

	<u>FY</u> <u>1996-97</u>	<u>FY</u> <u>1997-98</u>	<u>FY</u> <u>1998-99</u>	<u>FY</u> <u>1999-2000</u>	<u>FY</u> <u>2000-01</u>	<u>Percentage</u> <u>Change</u>
Room and Board—Semi-Private Room	\$ 350	\$ 350	\$ 375	\$ 470	\$ 515	47.1%
Intensive Care Increment—Trauma	1,511	1,556	1,626	1,707	1,865	23.4
Intensive Care Increment—Surgical	1,511	1,556	1,626	1,707	1,865	23.4
Intensive Care Increment—Medical	1,511	1,556	1,626	1,707	1,865	23.4
Intensive Care Increment—Pediatric	1,511	1,556	1,626	1,707	1,865	23.4
Intensive Care Increment—Burn Level 1	354	365	381	398	435	22.9
Intensive Care Increment—Burn Level 2	1,079	1,111	1,161	1,214	1,330	23.3
Intensive Care Increment—Burn Level 3	1,804	1,858	1,941	2,028	2,220	23.1

\* Rates shown are the published rates, but they do not reflect additional cost increments, such as for nursing services.



June 18, 2001

Janice Mueller, State Auditor  
Legislative Audit Bureau  
22 E. Mifflin Street, Suite 500  
Madison, Wisconsin 53703

Dear Ms. Mueller:

Thank you for the opportunity to review and respond to the Legislative Audit Bureau's (LAB) report and evaluation of the implementation and operating agreements between the University of Wisconsin (UW) and the University of Wisconsin Hospital and Clinics Authority (Authority) as required by s.13.94(1) (o), Wis. Stats. I appreciate your staff's professional and well-organized effort. The review has been particularly beneficial to me because of my short tenure at the Authority.

We are very proud of the continuing excellent reputation of UW Hospital and Clinics as it seeks to fulfill its vision to be the foremost healthcare provider and employer in Wisconsin, serving as a statewide and national leader for patient care, education, research, and community service. As acknowledged in LAB report, we continue to meet our statutory mission to deliver comprehensive, high quality health care, including charity care to the indigent; provide a suitable environment for medical instruction; sponsor and support healthcare research; and conduct outreach activities that assist health programs and personnel throughout the state in the delivery of health care.

The following comments are intended to address some of the more significant points included in your report.

### **Personnel and Employer Relations**

While I believe that UWHC currently has very good relations with its employees, we always strive to further increase employee satisfaction through a variety of means. We are asking employees about their perspectives through formal surveys, employee forums and small group meetings. As part of our newly developed strategic plan, one of our ten core strategies is to "improve employee retention and recruitment." This strategy includes initiatives to improve employee workspace, compensation, benefits, parking, and available training. Our budget for the upcoming year includes specific initiatives to enhance health insurance benefits, create wellness programs, enhance child care services, expand counseling programs, improve and expand cafeteria service, and provide on-campus personal services like laundry services and other services.

Relations with three of our employee unions are excellent. As cited in the LAB report, we instituted a new bargaining process called "RESOLVE." The process worked extremely well this last year and has allowed us to expeditiously negotiate three contracts starting in the year 2001 and extending for 2 and 3-year periods.

The bargaining process for a new contract with our nurses union has, on the other hand, extended beyond the contract renewal date of May 1, 2001. While we have made every effort to negotiate a new contract in a timely and collaborative manner, including the introduction of the "RESOLVE" process which worked well with the other unions, nursing union leadership has requested many changes. Some of the requests simply can not be economically achieved or be achieved in a short time frame. However, many of the concerns raised by the union are appropriate, and we have made changes to attempt to accommodate those concerns. We share, for example, their concern about mandatory overtime. However, the size, complexity and unpredictability of our inpatient population are greater than other local hospitals and requires us on various occasions to use mandatory overtime. We have historically placed constraints on the use of mandatory overtime and have extended those constraints, going so far as capping census on various occasions to minimize mandated overtime. A mediator has been involved in the negotiation process, and we have in every instance agreed to participate in the negotiations in a manner suggested by the mediator. At the date of this letter we continue to be hopeful of a satisfactory resolution of the remaining issues.

### **Financial and Operating Performance**

Some concerns have been raised by the LAB in their report about the financial trends in the industry and at the Authority.

#### **Profit Trends**

Most community and teaching hospitals have experienced declining profits during the years 1995 through 2000. The Authority also has experienced declining profits, especially in fiscal year 2000. For a significant time during this period the Authority also operated without a chief financial officer; however it did hire a chief financial officer in May of 2000. It has also recently completed a new strategic plan and is projecting a 5% margin for the current and next fiscal year. However, the industry will continue to be challenged by rising wage, drug, technology and other costs and third party payer reimbursement which continues to increase at a rate less than the rate of cost increases.

#### **Cash Reserves**

The level of cash reserves was raised as a concern at the formation of the Authority and is raised again in the LAB report. As noted in the table on page 48 of the LAB report, the decline in cash reserves has generally occurred for all hospitals since 1997. While the level of Authority's reserves has fluctuated, its cash reserves as a percent of the median reserves has improved since 1998 and is now 94% of the median. Cash reserves are primarily needed for unforeseen circumstances, including an unexpected loss from operations. Cash reserves are also needed to demonstrate credit worthiness to lenders but are also considered in relation to the institution's debt to total capitalization ratio. The Authority compares favorably to the market from this perspective. While a significant decline in existing reserves would reduce the Authority's ability to access the debt markets, this is not currently forecasted and the Authority plans to increase the reserves gradually.

## **Legislative Oversight**

The LAB report concludes that the mixed trends in financial and operational performance suggest that continued scrutiny of the financial performance of the Authority by the Legislature may be warranted. While we believe the LAB conclusion is appropriate, we would like to add that the Authority's financial performance is carefully monitored by the Authority's Board of Directors and its Finance Committee. The State and the University appoint the Board. The two co-chairs of the Joint Finance Committee (or their designees from among the membership of the Committee), as well as three members of the Board of Regents and the Chancellor of UW-Madison, are members of the Authority Board and receive all of the financial reports distributed monthly to the Board. In addition, the firm of KPMG performs an annual external audit of the Authority and reports its findings to the Finance Committee and the Board of the Authority. This governance structure already provides the Legislature the ability to regularly monitor the Authority's compliance with its statutory mission.

## **Authority Debt**

Lastly, the LAB report also comments on the circumstances that might cause the debt of the Authority to be assumed by the State. We believe further comment on this point is warranted. Credit has been extended to the Authority largely on the strength of the Authority's financial position and its operating results. At the time of the first bond issue, bond insurers were concerned about a termination by the University (not the Authority) of the Lease and Affiliation Agreements which would impede the Authority's access to its facilities, thus leaving inadequate provision for the repayment of the Authority's revenue bonds. Therefore, insurers sought a technical change and assurances from the University against a possible termination of the agreements by the University for the 30-year term of the bonds. The authority has maintained and will continue to maintain the terms of the Affiliation Agreement and the Lease Agreement, and expects to maintain its favorable financial position. Accordingly, there is very little likelihood that the State would become responsible for the outstanding debt of UWHC. Such assumption of the debt would only be triggered by an action of the University as a result of a substantial violation of the agreements by UWHC. Such a violation by the Authority is also highly unlikely since the University and the State appoint a majority of the Board members, and the Board could remedy any inadvertent action by management. The current comment in the LAB report may cause unnecessary concern on the part of the Legislature about the borrowing plans of UWHC. In fact, the State is in a more protected position today than when the UW Hospital was part of the University.

## **University of Wisconsin Medical Foundation (UWMF)**

The report expresses some concerns about the combined operations of UWMF since the merger with Physicians Plus. While UWMF has had to develop common operating procedures, align compensation formulas, create a common operating culture and struggle with other financial and business matters, these issues were not unexpected and are being resolved. The Authority and UWMF are working more closely together now than in the past on a variety of issues, and will assist each other in creating a cohesive culture for the medical staff.

Another concern noted was the lack of coordination of the charity care policies between UWHC and UWMF. This is an appropriate concern that has recently been recognized by both parties and will be addressed during the next twelve months.

I would like to thank you again for the thoughtful analysis provided by your staff and for the professional and collaborative approach to the audit. It has been instructive and helpful to all involved in the process.

Sincerely,

A handwritten signature in cursive script that reads "Donna S. Sollenberger".

Donna Sollenberger  
President and Chief Executive Officer

cc: John Torphy, Vice Chancellor  
University of Wisconsin

Jack Pelisek, Chairman  
University of Wisconsin Hospital & Clinics Authority