



UNC
HEALTH CARE

Report to the UNC Board of
Governors on the benefits we
derive from the Flexibility
Legislation granted the UNC
Health Care System by the
Legislature of the State of North
Carolina

FY 09

Report to the
UNC Board of
Governors

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EXECUTIVE SUMMARY

Background

The Legislation enabling limited flexibility to the UNC Health Care System (UNC HCS) requires an annual report to the North Carolina Legislature outlining the benefits derived from the legislation. Success of the UNC HCS is directly correlated to the flexibility legislation.

Flexibility in Personnel Policies and Programs

Flexibility programs allow the UNC HCS to select the best talent, to utilize non-traditional methods to recruit for high-need areas, and to compensate staff at market levels. The results of these programs have been higher quality care, higher patient satisfaction, increased employee satisfaction, reduced turnover, and better financial results.

Flexibility in Purchasing

Flexible purchasing activities have saved the UNC HCS almost \$30 million since the flexibility legislation was enacted. We achieved savings through enhanced collaboration, purchasing independence, and increased efficiency.

Flexibility in Property Matters

Flexibility legislation allows the UNC HCS to operate independently with regard to leasing arrangements. This section identifies the lease agreements which have been entered into during the past year.

Flexibility in Construction Matters

Flexibility legislation allows the UNC HCS to operate independently with regard to bidding construction contracts. This section identifies the projects the system has initiated using alternative bidding processes.

Managing in a Challenging Environment

The current economic climate made a challenging operating environment more difficult. The UNC HCS has mitigated difficult times by improving our fundamental operations. We have improved patient care, contained costs, by increased efficiency, and enhanced internal communication. Our ability to react quickly to the rapidly evolving situation was fostered by the flexibility under which we operate.

BACKGROUND

The University of North Carolina Health Care System was established on November 1, 1998 to integrate UNC Hospitals with the clinical patient care programs of the UNC School of Medicine. The vision of the UNC Health Care System (UNC HCS) is to be the Nation's leading public academic health care system--leading, teaching, caring. Improving the health of our patients and meeting their needs remains our primary focus. We must deliver excellent service and operate leading programs. We must be deeply and broadly engaged with the people of North Carolina and the Nation to meet their health challenges. Throughout, we must maintain financial viability, with margins sufficient to support our missions.

The authority granted in N.C.G.S. 116-37 subsection (d) personnel; subsection (h) purchases; subsection (i) property; and subsection (g) property construction has allowed the Board of Directors of the UNC HCS to approve the practices summarized below. The following report, depicting how this flexibility is utilized by the Chapel Hill component of the UNC HCS, will be sent to the Joint Legislative Commission on Governmental Operations on or before September 30, 2009, as required by statute.

FLEXIBILITY IN PERSONNEL POLICIES AND PROGRAMS

Hiring for Excellence

The UNC HCS continues to utilize Hiring for Excellence, a structured behavioral interviewing and selection process. All managers and staff who interview candidates use data-driven best practices. By recruiting the right team members, we are raising our skill level, enhancing continuity of care, and reducing employee turnover.

Recruitment/Sourcing Talent

The UNC HCS has implemented many programs to recruit talented employees. In addition to local, regional and national recruitment efforts, we sourced over 80 highly skilled and experienced registered nurses internationally, primarily in the United Kingdom. This strategy is designed to supplement domestic shortages for some skill sets.

Market-competitive compensation practices and the ability to quickly respond to changing markets enable us to attract and retain the best talent. The flexibility legislation has been fundamental to providing this necessary agility to the System.

We have eliminated dependence on expensive third-party contract labor for those jobs with limited supply and availability, especially registered nurses and certified registered nurse anesthetists. We paid \$10.9 million in FY08, \$5.5 million in FY09, and expect to be close to zero in FY10. We accomplished this with aggressive and targeted recruitment as well as flexible and competitive work schedules and compensation.

Employee Satisfaction and Turnover

The UNC HCS is increasingly the employer of choice in our highly competitive industry and market. We annually measure co-worker satisfaction as one key measure of our progress toward this goal. This spring, 80% of staff participated in the annual survey. The high participation rate affirms the results and indicates our staff feel ownership in the organization.

For nearly every survey item, we increased our scores significantly. Measured against a national database, our employee satisfaction and commitment jumped from the 62nd to the 71st percentile over the last year. In the first survey conducted with Morehead Associates in 2007, we ranked at the 33rd percentile. This steep improvement places UNC Health Care among the top performing healthcare organizations in the United States.

Voluntary employee turnover, the ratio of staff who voluntarily leave to the average number of permanent positions, is another indicator in which we have improved. Currently at 9.5%, this metric is significantly below the FY08 score of 11.9% and the FY07 score of 16.4%. By itself, the turnover number could be explained by the tough economic environment. However, given the improved employee opinion results, we believe the improving trend is, in part, due to our improving work climate.

Workforce Development

In an era of staffing shortages, improving the skills of our workforce is increasingly important. The UNC HCS, under the flexibility legislation, enhanced several programs to help co-workers gain the skills, certifications, or educational degrees needed to meet staffing needs.

Last year the system was planning stages a “Corporate University” model to align training and development with our business strategies. We have now developed The Learning Institute, a virtual entity that organizes staff training and education within the health care system. The Learning Institute provides a framework for knowledge sharing and strategic learning through four Colleges focused respectively on Leadership Excellence, Service & Quality Excellence, Clinical Excellence, and Workforce Development.

Enhanced Communication

In a large and complex organization, sharing important information and creating transparency is challenging. We have implemented several new tools to enhance communication.

“Glad You Asked” is a web-based communication tool that allows employees to pose questions directly to system leaders. Questions and responses are posted on the intranet for all employees to view. In its first year, we responded to over 800 questions and the website was visited over 24,000 times. It is one of the most frequently visited sites on the UNC HCS intranet.

Leadership Rounding continues to be a valuable technique used by all levels of management to interact with employees in their workplace. Improved employee opinion scores reflect that our leaders are visible and available to learn first-hand from employees. This presence further engenders employee trust in leadership and commitment to the values of the institution.

Reward and Recognition

We paid our employees an incentive reward in the fall of 2008 for their contribution to meeting quality, patient satisfaction, employee satisfaction, and financial goals. This was the third consecutive annual incentive award. Each year we have seen improved outcomes since developing a program to align performance goals with rewards. In FY09 we achieved all of our quality goals and made significant progress towards patient satisfaction, employee satisfaction, and financial goals.

Additional recognition efforts, ranging from thank-you notes to gift-cards and spot bonuses have also improved overall morale and the sense of respect and dignity commonly held among the workforce.

FLEXIBILITY IN PURCHASING

Flexibility in purchasing has furthered the success of the UNC HCS. This flexibility allows staff greater latitude negotiating purchase terms. Each year we document achieved savings and improved productivity. In the fiscal year ended June 30, staff documented savings of \$4.5 million, the highest in our history.

Documented Savings

During FY09, the Purchasing Department documented savings of \$4.5 million including \$1.1 million on capital purchases. The chart below illustrates each year’s savings since 2000. In aggregate, savings now approach \$30 million.

FISCAL YEAR	DOCUMENTED SAVINGS (MILLIONS)
FY 00	\$ 1.1
FY 01	\$ 2.0
FY 02	\$ 1.6
FY 03	\$ 1.4
FY 04	\$ 2.9
FY 05	\$ 3.4
FY 06	\$ 3.8
FY 07	\$ 4.1
FY 08	\$ 3.9
FY 09	\$ 4.5

Enhanced Collaboration

Leveraging several partnerships, we have furthered our success. Collaborating with physicians in our system yielded savings totaling \$460,000. We reduced our pricing for cardiac valves by \$90,000, for maxiofacial products by \$70,000, and for cochlear implants by \$300,000. We accomplished this without reducing the quality or range of products available to our patients.

Our collaboration with MedAssets, our group purchasing partner, remains strong. With their help, we find products that better meet the needs of our patients, often at reduced prices. As a recent innovation, we established a purchasing affiliate program. The program allows smaller hospitals access to MedAssets pricing. Our first affiliates are Beaufort Regional Medical Center in Washington, NC and Clarendon Health System in Manning, SC. Several other regional hospitals are exploring an affiliation with us. Aggregating their purchases with ours enables us to access still better pricing and a dividend for our purchases.

Purchasing Independence & Staff Efficiency

Prior to gaining flexibility we forwarded all orders \$10,000 to the State of North Carolina's Department of Administration's Purchase and Contracts Division in Raleigh for their approval before awarding the purchase order. We were required to follow a complicated series of steps including bids, justifications and approvals. The process required 90 days on average.

These high value purchase orders represented 7% of orders in FY09, but 77% of expense. High dollar purchase orders have increased from 2,858 in FY00 to 3,781 in FY09. Over the same timeframe, the Purchasing Staff has decreased. The statistics below demonstrate the efficiency gains we have realized.

CHANGE IN VOLUME FROM FY00 TO FY08	INCREASE FROM FY00 TO FY 09
Staff Level	-11%
Dollar Volume	58%
Number of Purchase Orders	12%
Number of Purchase Order Lines	37%
Average \$ per Purchasing Agent	44%
Average \$ per Purchase Order	41%
Average # of Purchase Orders per Agent	26%
Average # P/O Lines per Agent	54%
Average \$ per Purchase Order Line	15%
Average # Lines per Purchase Order	21%

Perhaps most important, we have garnered mutual advantage through affiliate entities in our health system. With Rex Healthcare, UNC Hospitals gains greater combined purchasing strength and we access negotiations on one another's behalf. Recently, for instance, UNC Hospitals accessed an additional \$200,000 price break on a robotic product in a joint negotiation with Rex. Similar opportunities are available with Chatham Hospital and UNC Physicians & Associates.

FLEXIBILITY IN PROPERTY MATTERS

Property involving leased space for Clinical Programs

The UNCHCS Property Committee reviews new leases and also renews existing leases. The following leases have been established during the past year:

1. A new lease was developed jointly by the UNC Health Care System and First Health to accommodate an Oncology Program in Sanford, NC. This space is adjacent to the UNC Hospitals' Medical Office Building in Sanford.
2. A new lease was established to accommodate the UNC School of OT/PT program. This 3,450 square foot space is located in Orange County (Hillsborough).
3. An existing lease for the UNC School of Speech and Hearing program was renewed for an additional 2 year term. This 3,200 square foot space is located in Durham County.
4. A new lease was established to provide clinical services for the School of Division of Pediatric Cardiology (Department of Pediatrics). This space is located in Greensboro, NC near Moses Cone Hospital.
5. A new lease was developed to accommodate growing clinical demand for the UNC School of Department of OB/GYN. This program relocated into expanded space located at Chapel Hill North.
6. A new lease was developed for the UNC School of Department of OB/GYN. The new Clinical Research program is located in Chapel Hill and consists of 5,478 square feet of space.
7. A new lease was developed for the UNC School of Medicines' Department of OB/GYN. The new lease is for the Horizons Program. The space consists of 8 apartments located at 1105 Hwy 54, Chapel Hill, NC.
8. A new lease was developed for the UNC School of Medicines' Department of Ophthalmology. The new clinical space allows the department to expand services to the Siler City area.
9. A new lease was developed for the UNC School of Medicines' Department of Psychiatry. The space consists of 3,065 square feet of space, and is located in Carrboro, NC.

10. The existing lease for space involving the UNC Health Care Systems' Oncology outreach program was renewed for an additional 1 year term. This program is located in Dare County.
11. The existing lease for space involving the UNC Hospitals' Trauma program. The space consists of 13,000 square feet of warehouse space and 3,000 office space.
12. The existing lease for space and grounds involving the UNC Hospitals' Helicopter program located at Cape Fear Valley Medical Center.

FLEXIBILITY IN CONSTRUCTION MATTERS

The Construction Bidding Oversight Committee uses approved criteria to determine when to utilize alternative forms of construction bidding (e.g., single-prime versus multi-prime). For the scale of our typical renovation project, single-prime contracting has proven effective. This method provides for public bidding of construction work as required while Project Managers more efficiently coordinate with a single entity. Therefore, the Construction Bidding Oversight Committee has approved the use of single-prime contracting for typical renovation projects. For non-typical projects, a formal presentation, review, and discussion of proposed alternative bidding methodologies is required.

Projects initiated using single-prime bidding as approved by the Construction Bidding Oversight Committee:

1. 6 Bed Tower (Negative Pressure Rooms) – to provide additional rooms with negative pressure for isolation of patients.
2. Neurosciences Hospital (Café Renovation) – to convert the space vacated by Wendy's as needed for NFS operations.
3. 5 West (Patient Unit Renovation) – to upgrade an outdated patient unit as part of the Inpatient Bed Relocation project.
4. Vascular Interventional Radiology (Replacement) – to replace VIR equipment with updated technology.
5. Prosthetics and Orthotics – to enhance space providing patient care and prosthetics production.
6. Adult Cardiac Catheterization Laboratory Holding Bays – renovations in existing catheterization laboratory to create additional holding bays to support increased demand for services.
7. Pre-Care Examination Rooms – renovations to improve the efficiency of patient care.
8. Planning Department Offices – to relocate the Planning Department to accommodate the conversion of 6 Patient Support Tower offices to create an inpatient unit.

Design contracts approved for the following projects in accordance with the designer selection procedures approved by the UNC HCS Board of Directors:

1. Sprinkler System Expansion – expansion of the sprinkler system to create a building separation from adjacent buildings without sprinklers.
2. Magnetic Resonance Imaging 2 Replacement – replacement of existing MRI equipment with updated technology.
3. 5 East Patient Unit Renovation (Burn Center Expansion) – renovation of an existing patient unit as part of the Inpatient Bed Relocation and 68 Bed Certificate Of Need plan.
4. Patient Room Ceiling Lifts – installation of ceiling mounted patient lifts to all Intensive Care Unit rooms and selected acute care rooms to safely handle patients prevent injuries.
5. 4 Bed Tower Modular Toilet Replacement – replacement of problematic modular toilets on the Medical ICU/Medical Progressive Care Unit.
6. Nurse Education – renovation of administrative and education space in the Old Infirmary Building to provide improved facilities for nurse education and training.
7. Vascular Interventional Radiology 3 Replacement – replacement of existing VIR equipment with updated technology.
8. Magnetic Resonance Imaging 7 – add a MRI unit to meet increasing demand for services.
9. Prosthetics and Orthotics – upgrade space to provide improvement patient care and prosthetics production.
10. Adult Cardiac Catheterization Laboratory Holding Bays – renovations to create additional holding bays in the existing Cath Lab to support increased demand for services.
11. Precare Exam Rooms – renovations to improve patient flow.
12. Procedure Recovery Unit Beds – renovations to create two licensed beds in the Procedure Recovery Unit to facilitate faster admission and to accommodate additional patients transferred from other North Carolina hospitals to UNC Hospitals.

MANAGING IN A CHALLENGING ENVIRONMENT

With the worsening economy, the UNC HCS faces severe challenges. The jolting impact of the recession has accelerated underlying trends that threaten to destabilize our financial health. The rapid rise in unemployment precipitated rising uninsurance. Demand softened with the fall in consumer confidence and employment, particularly for semi-elective care. Like other state institutions, we suffered an appropriations cut. Stock market losses substantially reduced our reserves, thereby eroding our protection against further downturns and diminishing our capacity to invest in capital projects.

Of these factors, the increased uninsurance is the most difficult. Patients without insurance typically pay less than 5% of the total cost of their care. In recent years, we provided about a 10% more care to uninsured patients annually, or roughly double our overall growth. Underlying this trend is the increasing cost of private health insurance and the gradual erosion of employer-based coverage.

Not surprisingly, increased unemployment also increased uninsurance. For UNC Hospitals, each 1% rise in the unemployment rate has historically caused a 6% drop in managed care volume, no change in Medicare volume, a 3% increase in Medicaid volume, and a 6% increase in our uninsured volume. In dollar terms, a 1% rise in unemployment equates to a \$14.4 million drop in our cash collections.

While a 1% change is troubling; a 6% change is potentially catastrophic. Yet that is exactly the scenario we face. In January, 2008, North Carolina's unemployment was below 5%; today it is about 11%. On an annual basis, if history holds, we would expect about an \$86 million decline in what we are paid for the services we provide. To describe the magnitude of the issue, our cost of providing uncompensated care rose from \$208 million to \$227 million to \$272 million for the fiscal years 2007 through 2009, respectively. This year, we expect to provide \$300 million in uncompensated care. We further expect one of every seven of our patients will lack insurance coverage.

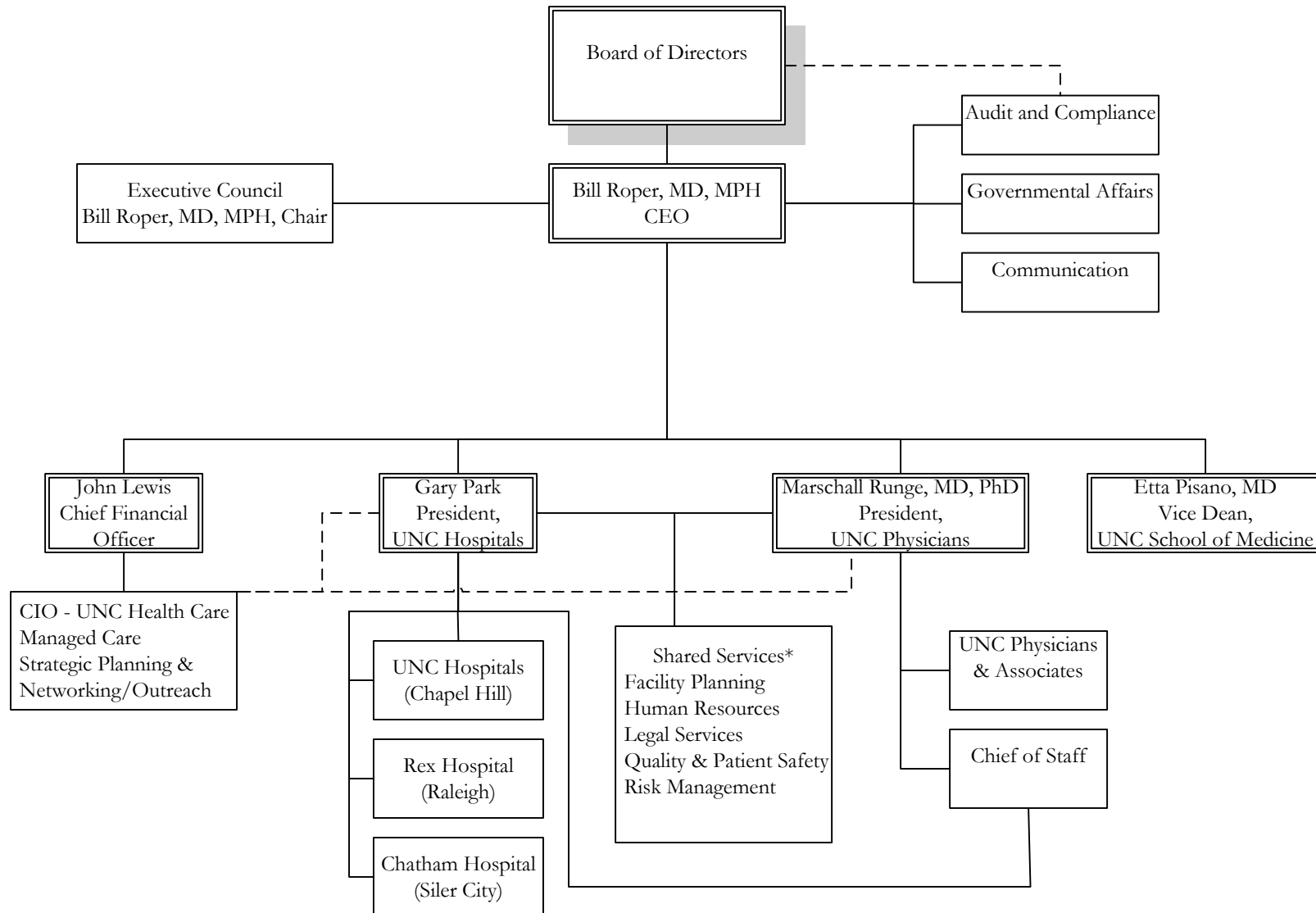
It is hard to find silver linings in this economic crisis. Yet there have been several. The flexibility afforded the UNC HCS has been instrumental in allowing us to nimbly respond to new challenges. We renewed our focus on efficiency and cost containment. We sharply curtailed, if not eliminated, discretionary spending. We painstakingly scrutinize positions before adding or replacing staff. Turnover has dropped to a record low level which is crucial for enabling us to improve both quality and efficiency. We can be extremely selective in hiring. We have decreased our reliance on overtime and temporary staffing. Our co-workers are more committed than ever to providing a great patient experience. Our investments in program growth have been targeted to the programs most core to our multiple missions.

These changes have helped us stave off financial distress in the first part of the recession. As has been the case with other industries, the recession exposes the financial vulnerabilities health systems face. At the UNC HCS, we have provided far more uncompensated care than ever before and anticipate that we will provide even more this year. We have improved our efficiency, but cannot address the underlying challenges in isolation. As has been commonly recognized in the public debate, we need a solution that curbs growth rates and cost inflation and assures coverage to more or all North Carolinians.

APPENDICES

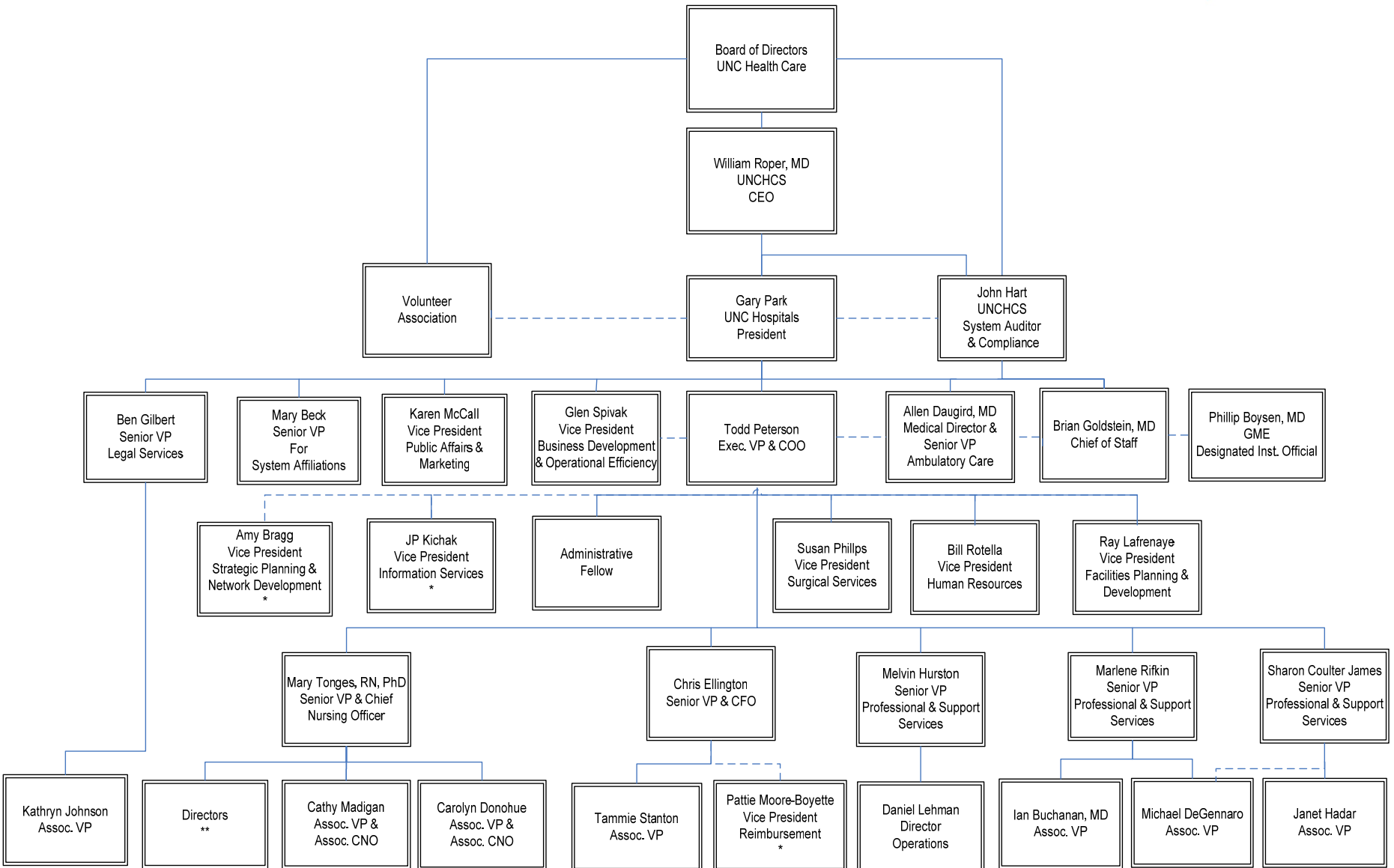


Organizational Chart
August 1, 2008



*The shared services components work collaboratively across the UNCHCS, and Mr. Park and Dr. Runge will work in partnership in these areas.

UNC Hospitals Table of Organization



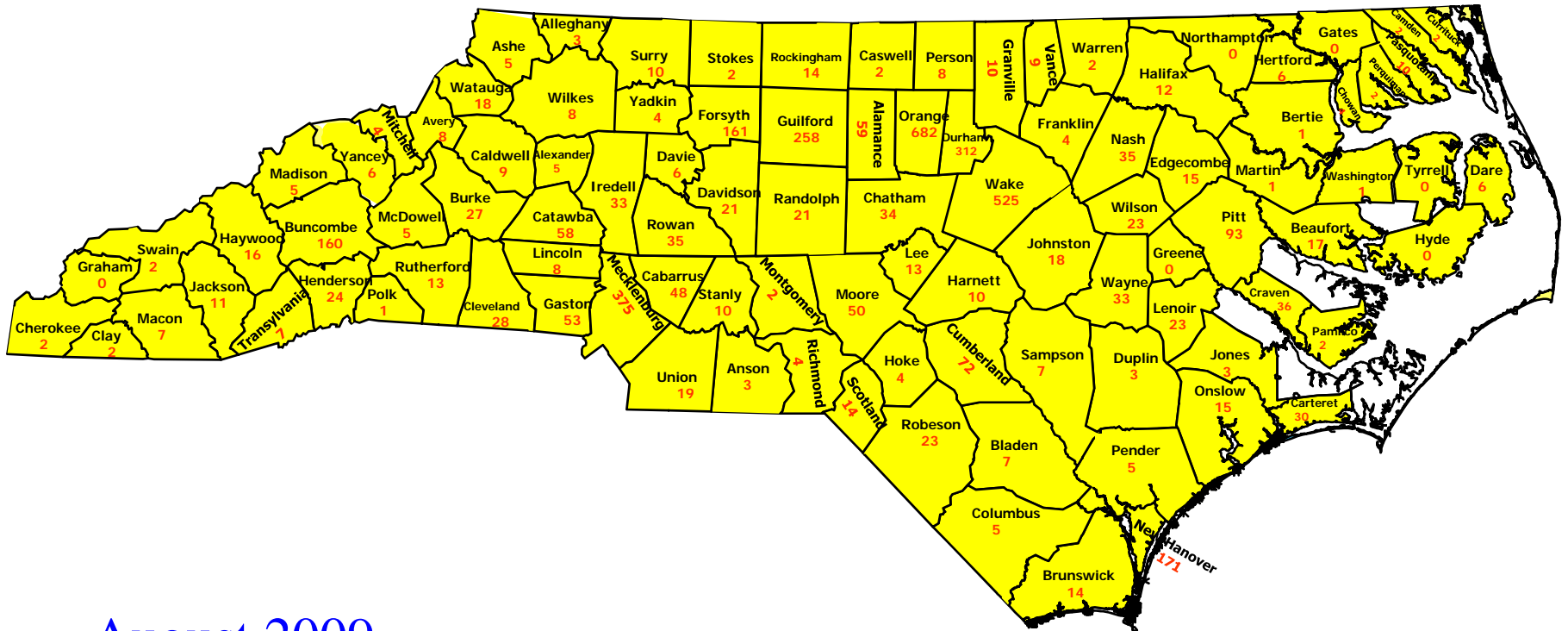
* Primary reporting is to UNCHCS CFO.

** Ms. Merryman; Ms. Morales; Mr. Ray; Ms. Spahl; Mr. Strickler

UNC-CH School of Medicine Alumni and Former Residents, UNC Hospitals

(duplicates eliminated)

Total of unique individuals: 3956



August 2009