



UNC
HEALTH CARE

Health Care System Annual Report

FY11

This annual report to the UNC Board of Governors addresses the benefits gleaned from the Flexibility Legislation granting the UNC Health Care System the ability to operate as a special enterprise.

Report to the
UNC Board of
Governors

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 maintained by the UNC School of Medicine.

The vision of the UNC Health Care System 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 stability in support of 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 Health Care System to approve the policies summarized below. In the following report, we detail how we use this flexibility to improve the operations of the UNC Health Care System. As required by statute, we will convey the report to the Joint Legislative Commission on Governmental Operations in September 2011.

Annual Report

In caring for patients across all 100 counties in North Carolina (Appendix I), the UNC Health Care System improves the well-being of the state. As in past years, this year we can report many successes accruing to the UNC Health Care System due, in part, to the operational latitude granted under the statute.

Fiscal year 2011 was a successful year for the UNC Health Care. In a quickly changing, economically distressed environment, we improved the quality of our care, improved our cost effectiveness, reacted nimbly to new challenges and opportunities, and improved our financial stability.

With stable operations, we were able to provide substantial uncompensated care to the citizens of North Carolina while improving our performance on our research, education and clinical missions. In fiscal year 2011, the UNC Health Care System provided uncompensated care at a cost of \$333 million, up from \$309 million in fiscal year 2010.

Personnel

UNC Health Care's exemption from the State Personnel Act remains the most important element of our statutory flexibility. As in prior years, the State faces fiscal challenges that limit compensation enhancements for State employees. Such limitations are problematic in the health care market. Despite continued high unemployment in most sectors of the economy, unemployment for health care workers has remained extremely low. Throughout the current recession, health care employment has increased (Appendix II), and wages have risen.

The UNC Health Care System has adopted many programs to compete for qualified professionals. These programs have helped us recruit and retain better trained care-givers with quantifiable benefits. Since 2007, our relative employee turnover declined from 16% annually to about 9.5% (Appendix III). Over the same period, we have similarly cut our premium labor expense by almost 40% since 2008 (Appendix IV). Concurrently, we improved our employee satisfaction scores from the 33rd percentile to the 74th percentile (Appendix V) compared with peer institutions, and to the 91st percentile compared with other Academic Medical Centers.

We have accomplished these positive developments by recognizing and rewarding our workforce, emphasizing communication, demonstrating our commitment to co-worker satisfaction, hiring competent staff who “fit” with our ethos, articulating objective organizational goals, improving training, and creating career advancement opportunities. Each of these objectives is coupled with specific programs that we are weaving into the fabric of the UNC Health Care System culture (Appendix VI).

We also have offered competitive financial rewards to our co-workers. Our incentive plan enables all co-workers to earn additional salary by accomplishing organizational quality, service, satisfaction and financial goals. In each of the last several years, we have triggered payments by achieving most of these objectives (Appendix VII).

Despite these successes, we face renewed challenges due to wage pressure. In 2009, we opted to forgo pay increases. In 2010, we made modest market adjustments for our co-workers. With wages increasing industry-wide as well as within this region, we have maintained but not improved our competitiveness. Nearly half of our co-workers are paid below market (Appendix VIII), some substantially so. As we expand our services to meet growing needs, we face the added challenge of growing our workforce by 400 new co-workers this year.

We can only hire and retain co-workers with competitive compensation. As we hire new FTEs, we also strive to maintain internal compensation parity, especially because we are in an environment in which all of our salary information is public. Since 2009, our co-workers' salaries are easily accessed on the internet. With unquestionably transparent compensation information, all applicants, co-workers, or curiosity seekers are free to examine and compare salaries. We are now experiencing the

repercussion of these realities. As an example, we recently completed significant expansion of operating rooms at the UNC Ambulatory Care Center. In order to recruit adequate staff to open those new ORs, we had to expand the practice of offering referral rewards and sign-on bonuses.

Though compensation is challenging, the efforts described above have led to low turnover. This has produced improved employee satisfaction with the stability to improve quality, reduced personnel expense, and provided service that our patients recognize as simply better (Appendix IX.)

Purchasing

Statutory flexibility in purchasing has reduced acquisition costs, increased efficiencies and expanded our purchasing power. This benefits UNC Health Care, its partner institutions, as well as the State's purchasing organization.

Each year our co-workers in Purchasing document savings realized from the flexibility legislation. In fiscal year 2011, we recorded a \$5.0 million benefit. Since first granted flexibility, we have documented more than \$39 million in savings (Appendix X). These savings are realized due to negotiations and other practices that fully leverage the strength of the UNC Health Care System. We gain additional leverage with MedAssets, our group purchasing organization (GPO). Through MedAssets contracts, we successfully source products that meet the needs of our patients, often at substantially reduced prices.

Within UNC Health Care, we have achieved pricing parity to reduce cost. We commonly found that UNC Hospitals and Rex Healthcare purchased similar items at different unit costs. We have eliminated these differentials accessing the lower entity's pricing. With Rex Healthcare, we additionally combined purchasing strength; these changes sometimes require operational changes. Finally, we also established a purchasing affiliate program. Smaller hospitals across the region gain access to our pricing, thereby leveraging our purchasing power on their behalf. Margaret R. Pardee Hospital in Hendersonville, NC, is a great example of this. This summer we took over the management of Pardee and added them to our affiliate program. The resulting increase in buying power enabled a commitment from MedAssets to save UNC Health Care \$1 million.

We also gauge the benefits of purchasing flexibility in staffing efficiencies. Before flexibility, all orders greater than \$10,000 were forwarded to the State's Purchases and Contracts Division for their approval prior to the awarding of purchase orders. This process often required 90 days or longer. We additionally faced bidding requirements that were resource intensive without necessarily yielding advantageous pricing. By acting more independently, the size of the purchasing staffing has not grown despite a many-fold increase in its activity. (Efficiency improvements are detailed in Appendix XI.)

Construction and Property Management

Flexibility in construction and property management has yielded benefits in terms of our ability to act responsively, to manage cost-effectively, and to oversee projects responsibly. Due to rapid growth, a need to improve ease-of-access to our services, and aging facilities, we have invested heavily in on-campus and off-campus locations. Our ability to keep pace has been enabled by the processes put in place in accordance with the flexibility legislation. Two UNC Health Care System management committees, the Construction Bidding Oversight Committee and the Property Committee, oversee these activities in accordance with the statute.

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 versus construction manager at-risk (CM at-risk). As with other building projects across the UNC System, we typically employ the CM at-risk delivery model for major projects. A construction manager commits to deliver the project within a guaranteed maximum price and absorbs the risk of delivering the project on time and on budget. UNC Hospitals' newly-opened Imaging & Spine Center and the newly-expanded and renovated UNC Ambulatory Care Center are examples of how well CM at-risk projects work. This method enables us to bid projects publicly while still capturing the efficiency of coordinating with a lead contractor.

Through the UNC Health Care System Property Committee, the Board reviews new leases, and renewals of existing leases (Appendix XIII). Similar to purchasing flexibility, the statute allows the UNC Health Care System to efficiently enter into leased space contracts, with approval from the Property Committee and the UNC Health Care System Board.

With the Property Committee's guidance, we moved patient care programs from the main campus to better accommodate increased demand of services and substantially expanded our clinical presence in the communities nearby the Chapel Hill campus and across North Carolina. Immediately off Interstate 40, for instance, we have leased the majority of available physician office space. The "UNC Healthway" enables our patients to conveniently access outpatient services from major thoroughfares. Further, these transactions help place components of existing programs into contiguous spaces, improving efficiency and convenience for patients and clinicians.

Conclusion

The flexibility which the legislature gave to the UNC Health Care System is essential to our operations. As detailed above, it has enabled us to recruit and retain highly qualified co-workers, acquire goods and services cost-effectively, build patient-centered facilities, ease access to our services, and grow in a responsive, efficient manner. These, in turn, have been essential elements to improving our quality, service and breadth of clinical programs. As a result, we better meet our commitment to care for all North Carolinians.

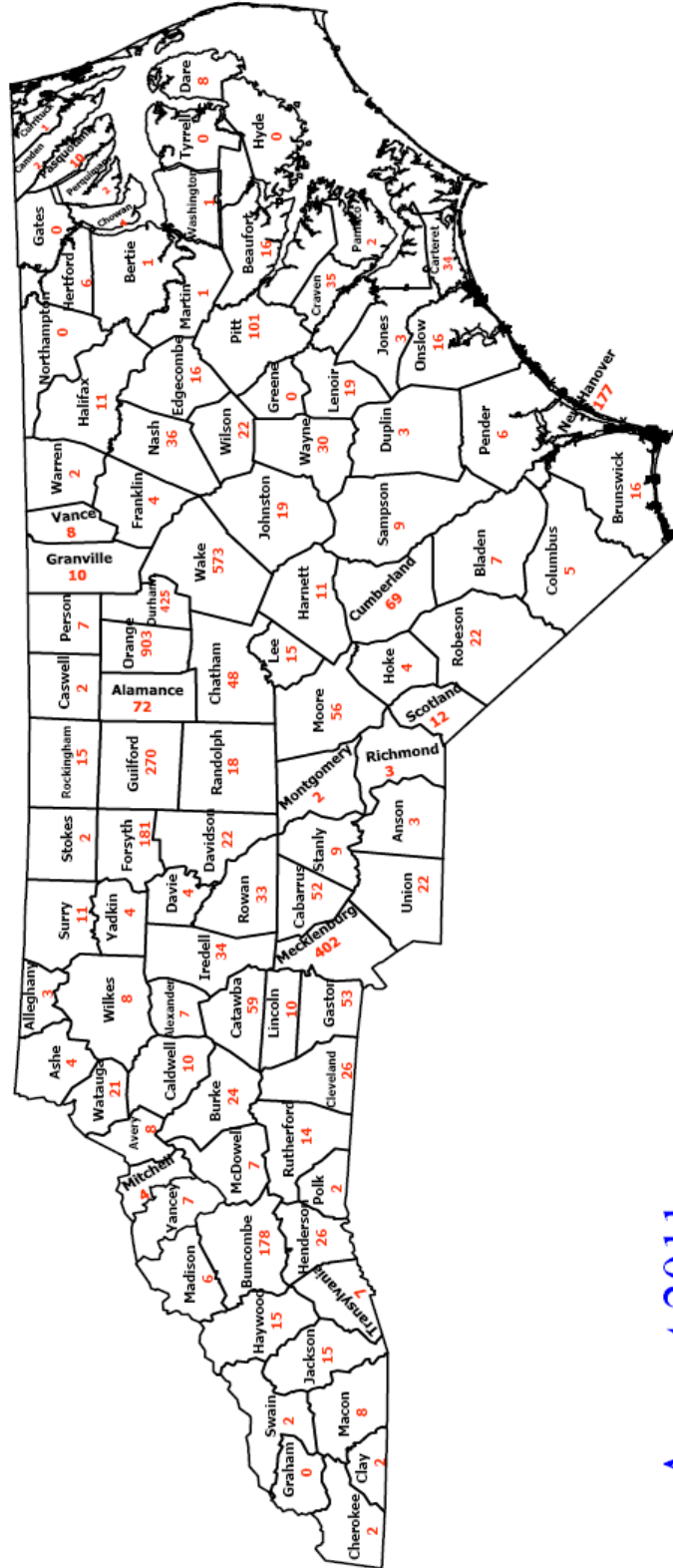
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- IV. PREMIUM LABOR EXPENSE
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UNC-CH School of Medicine Alumni and Former Residents, UNC Hospitals

(duplicates eliminated)

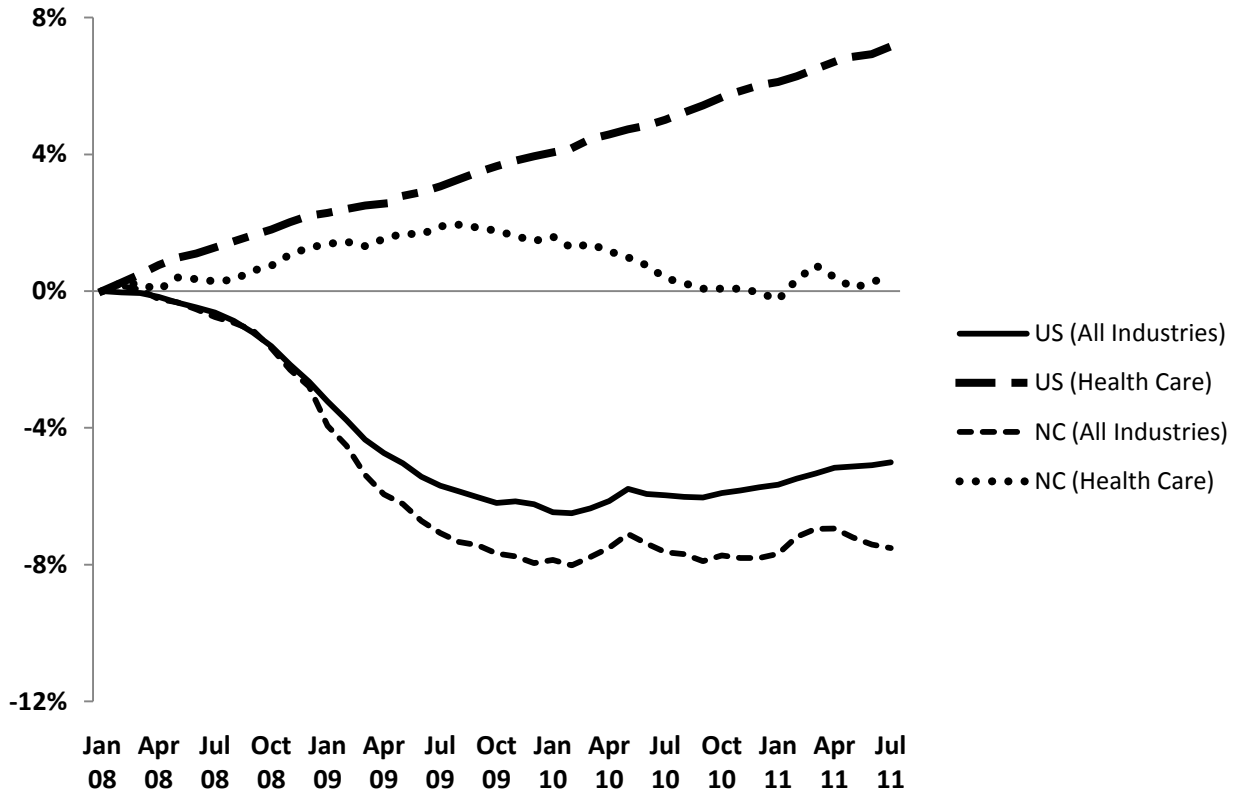
Total of unique individuals: 4477



August 2011

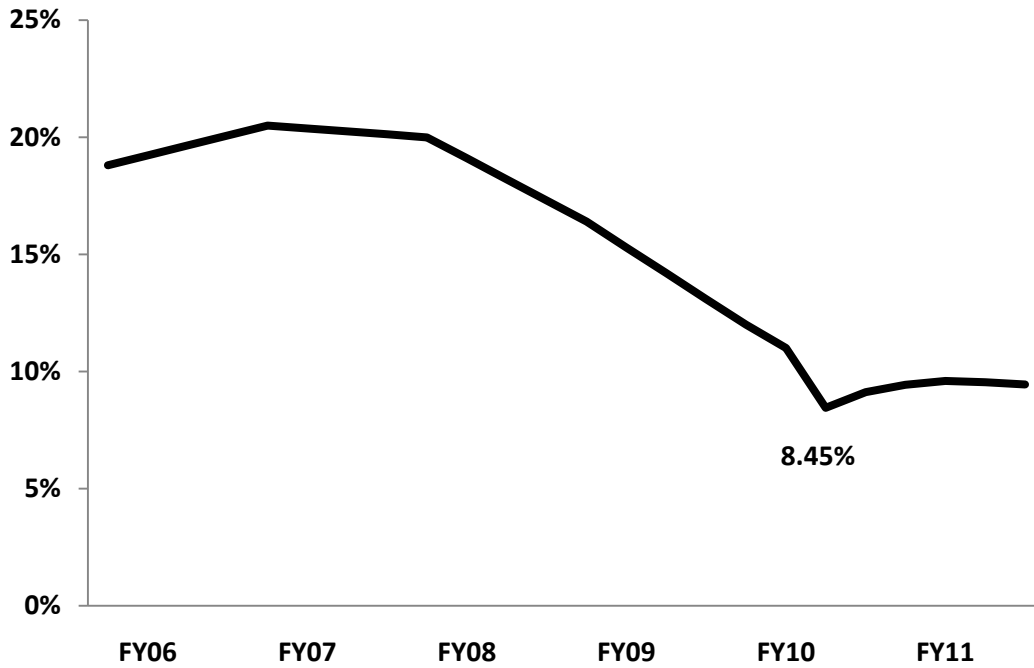
Appendix II NC & FEDERAL EMPLOYMENT TRENDS

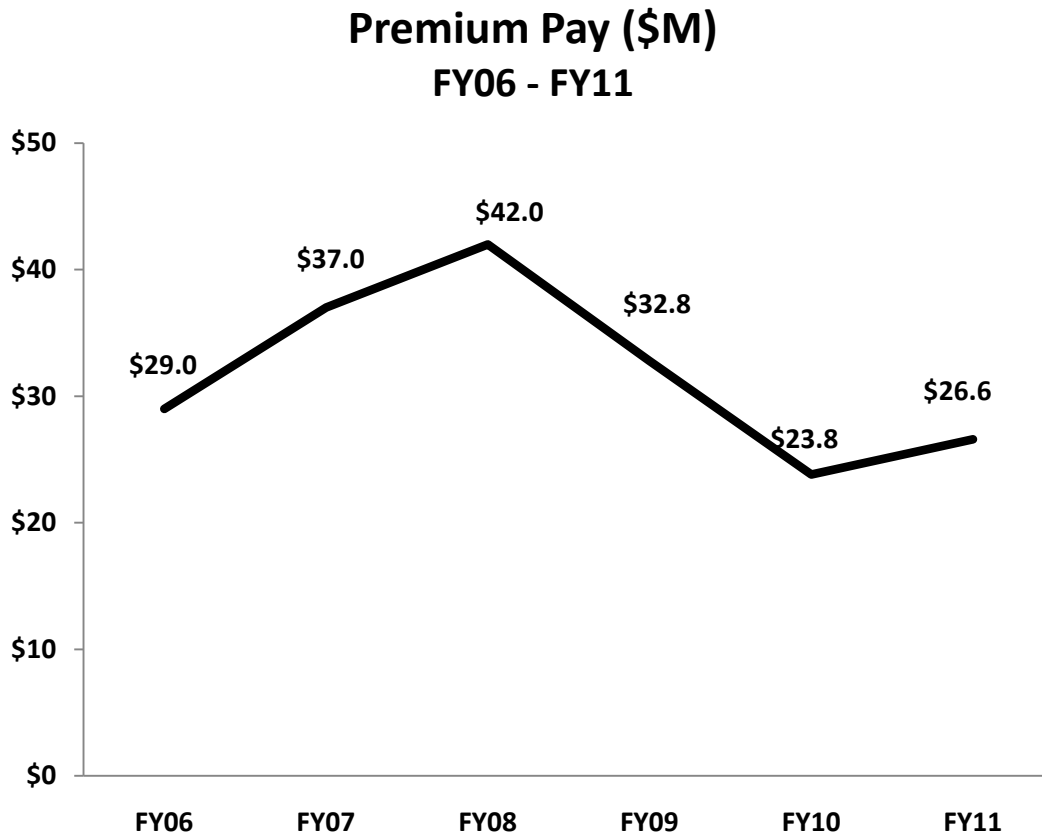
From NC Labor Market Information Division CY08 - CY11

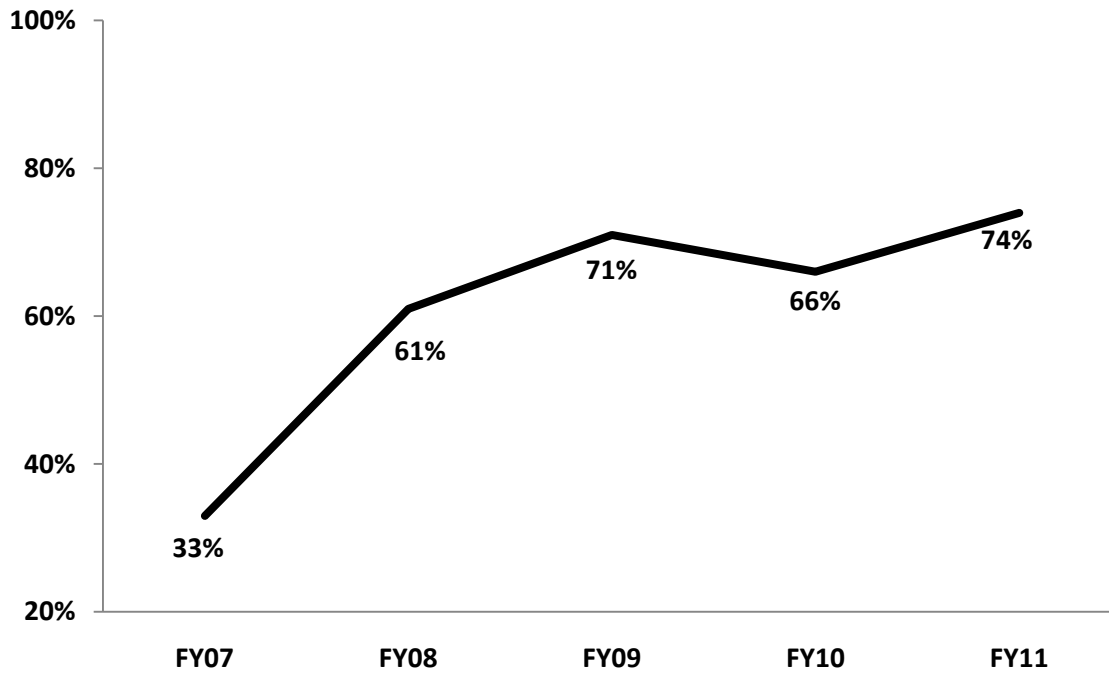


Appendix III EMPLOYEE TURNOVER RATES

UNC HCS Employee Turnover FY06 - FY11



Appendix IV PREMIUM LABOR EXPENSE

Appendix V EMPLOYEE SATISFACTION HISTORY**Employee Satisfaction Percentile
vs Other Morehead Hospitals**

Appendix VI UNC HEALTH CARE CULTURE

Hiring for Excellence

The UNC Health Care System utilizes 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 raise our skill level, enhance continuity of care, and reduce 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 have sourced almost 100 highly skilled and experienced registered nurses internationally, primarily in the United Kingdom. This strategy is designed to supplement domestic shortages for some skill sets.

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 \$5.5 million in FY09, and were close to zero in FY10. In FY11, a tight healthcare employment market and capacity expansions at UNC Health Care necessitated increased third-party contract labor. We have spent \$1.2 million on third-party contract labor in FY11 but have worked diligently to keep this type of expense low.

Workforce Development

In an era of staffing shortages, improving the skills of our workforce is increasingly important. We have launched the UNC Health Care Learning Institute to align training and development with our business strategies. It is 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. We've also worked closely with local technical schools to develop/support training curricula that align with our short- and long-term needs. Our Employee Opinion Survey results indicate that employee perception of career development opportunities continue to improve as we implement these strategies.

Enhanced 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. This year we responded to over 1,500 questions, and the website was one of the most popular and most frequently visited sites on the UNC HCS intranet.

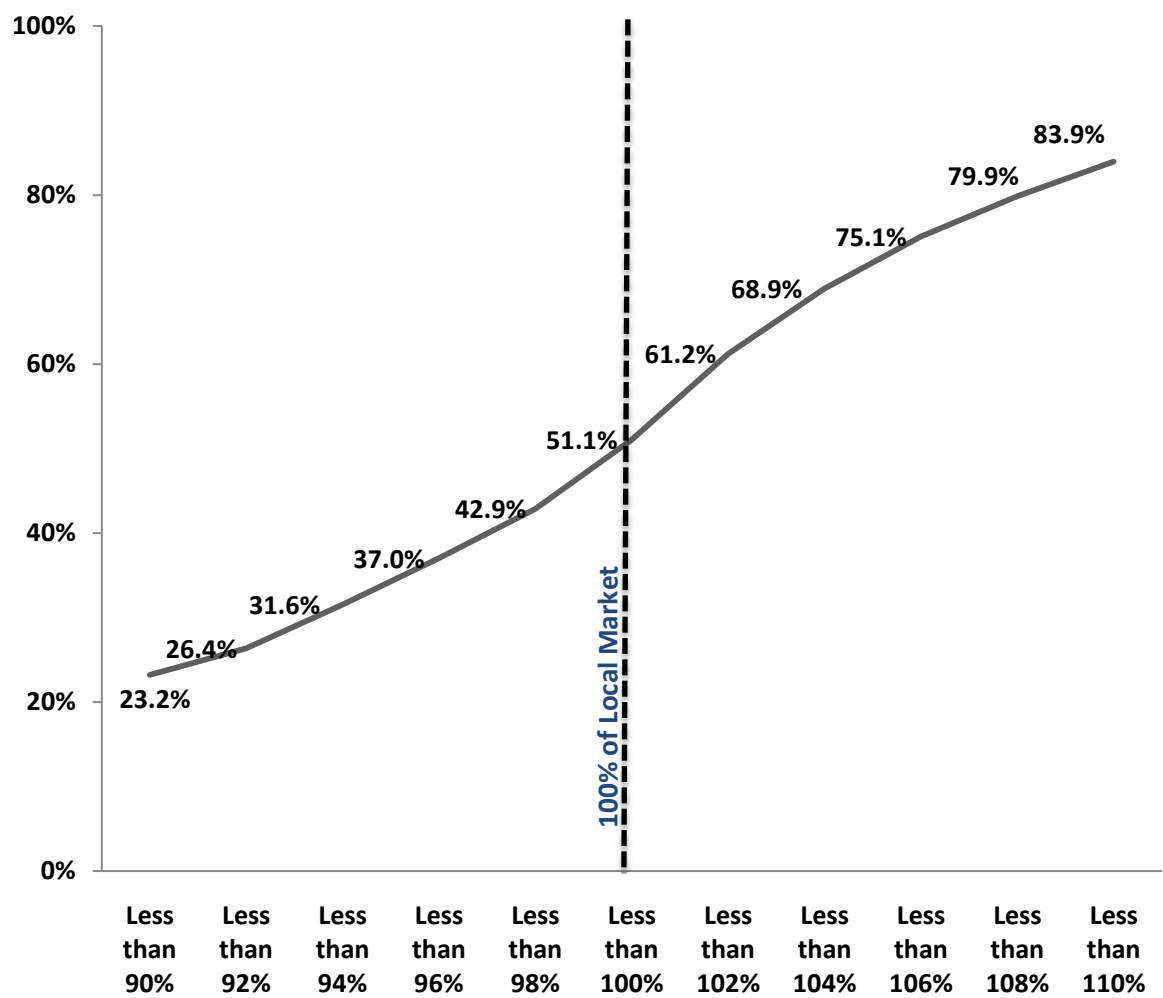
Leadership Rounding continues to be a valuable technique used by all levels of management to interact with employees in their workplace. Improved employee opinion scores reflect that our leaders are visible and available to learn first-hand from employees. This presence further engenders employee trust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

Appendix VII **UNC HEALTH CARE INCENTIVE COMPENSATION PAYMENTS FY06-FY10**

	FY06	FY07	FY08	FY09	FY10
Payout per FTE	Greater of 2.5% or \$750	Greater of 3.0% or \$1,000	Greater of 1.5% or \$750	2.01%	2.53% of gross pay
Min payout per FTE	\$750	\$1,000	\$750	\$114	\$0
Max payout per FTE	\$3,468	\$4,376	\$2,251	\$3,958	\$4,850
Eligible FTEs	\$4,548	\$4,927	\$5,124	\$6,323	\$6,261
Total expense	\$5.9M	\$8.1M	\$4.9M	\$6.5M	\$8.0M

Appendix VIII

COMPENSATION TREND AND MARKET DIFFERENTIAL



Appendix IX SELECTED EXTERNAL ACCOLADES

UNC Hospitals ranked #1 among Triangle hospitals in HCAHPS

UNC Hospitals ranked #1 among Triangle hospitals in 9 of the 10 categories of the latest Hospital Consumer Assessment of Healthcare Provider Systems (HCAHPS) survey. Rex Healthcare was the only Triangle hospital besides UNC to rank #1 in more than one category. Rex tied for first in three categories. The U.S. Department of Health and Human Services administers the HCAHPS survey.

US News and World Report "America's Best Graduate Schools"

The UNC School of Medicine was once again ranked highly by *U.S. News and World Report* in the magazine's 2012 "America's Best Graduate Schools" issue. The School ranked 2nd in Primary Care and 20th in Research overall. Family Medicine, Rural Medicine, and AIDS were also listed as top ten specialties.

US News and World Report "America's Best Hospitals"

Five specialties at UNC Hospitals that were nationally ranked by U.S. News & World Report in its annual "America's Best Hospitals" issue:

Ear, Nose & Throat - #20

Gynecology - #30

Pulmonology - #40

Nephrology - #41

Gastroenterology - #44

Additionally, the specialty areas of Cancer, Urology, and Geriatrics were designated by U.S. News as high performing, representing the top 25 percent of hospitals in their specialty nationally. This is the 19th year in a row that multiple specialties at UNC Hospitals have been included in U.S. News & World Report Best Hospitals list.

US News and World Report "America's Best Children's Hospitals"

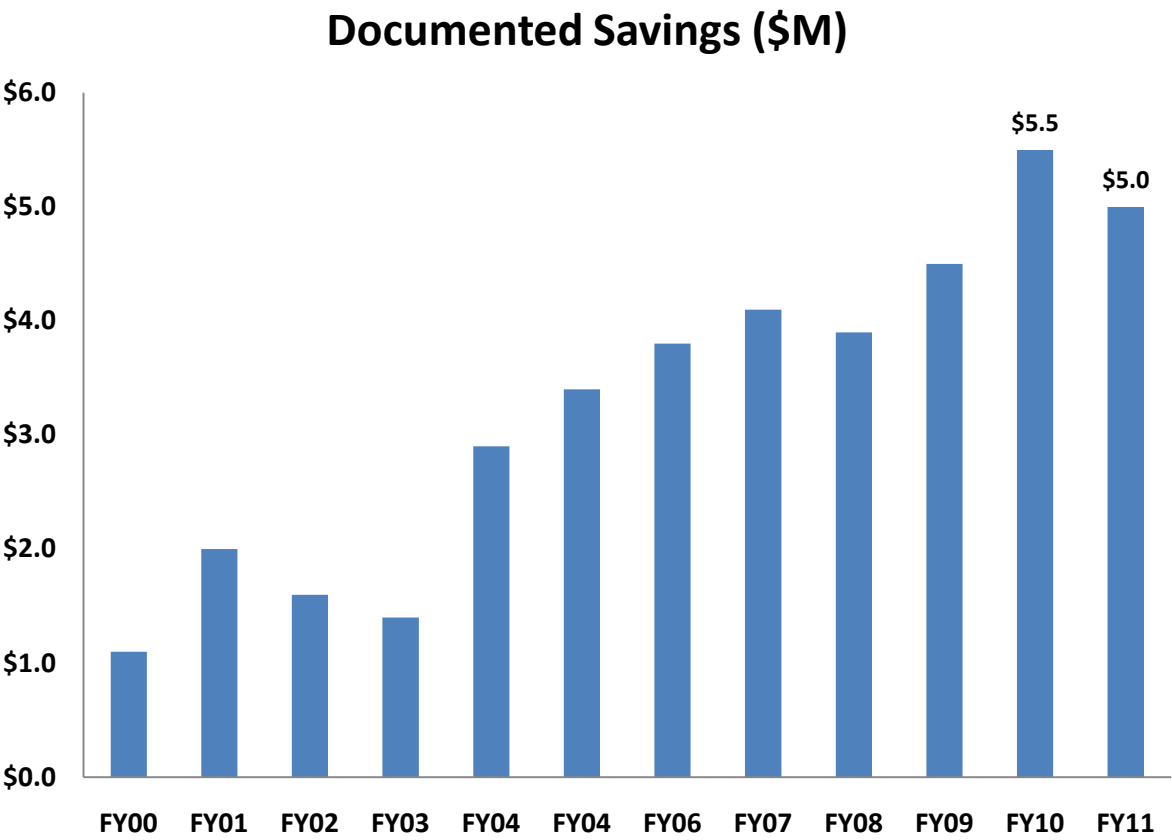
NC Children's Hospital has been ranked in 6 of 10 U.S. News Media Group's "America's Best Children's Hospitals" ranking categories, including a Top 10 ranking in pulmonology—the only top 10 ranking achieved by any children's hospital in North Carolina

UNC Physicians Listed in The Best Doctors in America 2011-2012

242 University of North Carolina at Chapel Hill School of Medicine physicians named to list. Largest number ever included in the compilation of The Best Doctors in America database. Up from 219 in 2009-2010

88 UNC Health Care Physicians recognized by Castle Connolly as "America's Top Doctors"

Appendix IX PURCHASING SAVINGS FY00-FY11



Appendix XI PURCHASING EFFECIENCY FY00-FY11

Purchasing Efficiency Measures	Percent Change from FY00 to FY11
Staff Level	-11.1%
Dollar Volume	76.8%
Number of Purchase Orders	29.8%
Number of Purchase Order Lines	49.8%
Average \$ per Purchasing Agent	98.9%
Average \$ per Purchase Order	36.2%
Average # of Purchase Orders per Agent	46.0%
Average # P/O Lines per Agent	68.6%
Average \$ per Purchase Order Line	18.0%
Average # Lines per Purchase Order	15.0%

Appendix XII CONSTRUCTION AND PROPERTY MANAGEMENT PROJECTS FY11

FY11 CM AT RISK CONSTRUCTION PROJECTS

Location	Activity	Improvement
UNC Hospitals - Hillsborough Campus	New Construction	Phase 1 - 60,000 sq. ft. physician office building Phase 2 - 50-bed acute care hospital; 18-bed ICU
UNC Health Care Imaging & Spine Center	New Construction	Convenient facility off of NC Hwy 54. Facility offers both Imaging and Spine care services

FY11 SINGLE PRIME CONSTRUCTION PROJECTS - IN PROGRESS

Location	Activity	Improvement
UNC P&A Orthopaedics	New Construction	Prompt Care clinic at Carolina Pointe II
UNC P&A Laser & Aesthetic Center	New Construction	New clinical space. Construction part of lease provisions.
UNC Hospitals - Geriatric Center	New Construction	New clinical space. Construction part of lease provisions.
Carolina Crossing	Renovation	Renovated clinical space. Construction part of lease provisions.
UNC Hospitals - Carolina Pointe II	Renovation	Podiatry Clinic at Carolina Pointe II
UNC Hospitals' 5 BT Nurse Stations	Renovation	Upgrade outdated facilities to improve operation and efficiency
UNC Hospitals' sprinkler system	Expansion	Expansion to unsprinklered areas, creation of building separation from other University buildings
UNC Hospitals' Operating Rooms	Renovation	Upgrade electrical systems
UNC Hospitals' Emergency Department	Renovation	Improve ED Egress and Security
UNC Hospitals' ISD	Expansion	Meadowmont Data Center expansion
UNC Hospitals' 3 Bedtower	Renovation	AU Relocation
UNC Hospitals' Pharmacy	Renovation	Pharmacy space reconfiguration
UNC Hospitals	Expansion	Expansion of Cath Lab capacity & equipment replacement

Appendix XII CONSTRUCTION AND PROPERTY MANAGMENT PROJECTS FY11

FY11 CONSTRUCTION PROJECTS - COMPLETE

Location	Activity	Improvement
UNC Hospitals' MRI	Expansion	Add an additional MRI system to meet increasing demand. MRI 7 complete.
North Carolina Children's Hospital	Reconfiguration	Reconfiguration of Children's exam rooms & hub registration
UNC Hospitals	Renovation	installation of patient room ceiling lifts
UNC Hospitals' Burn Center expansion	Renovation	Renovate existing patient unit as part of inpatient bed relocation, 5 East
UNC Hospitals' Wound Care Clinic	Expansion	Installation of Hyperbaric Oxygen Chamber #4
UNC Hospitals' Cystology	Reconfiguration	Reconfiguration for equipment upgrades
Meadowmont Heart & Vascular Clinic	Expansion	Upgrade outdated facilities to improve operation and efficiency
UNC Hospitals' 6 West	Renovation	Cosmetic improvements after unit relocated to NC Cancer Hospital
Nuclear Medicine	Expansion	Upgrade outdated facilities to improve operation and efficiency, USP 797
UNC Hospitals	Renovation	Pet/CT Scanner Replacement

Appendix XIII LEASE AGREEMENTS INITIATED OR RENEWED IN 2011

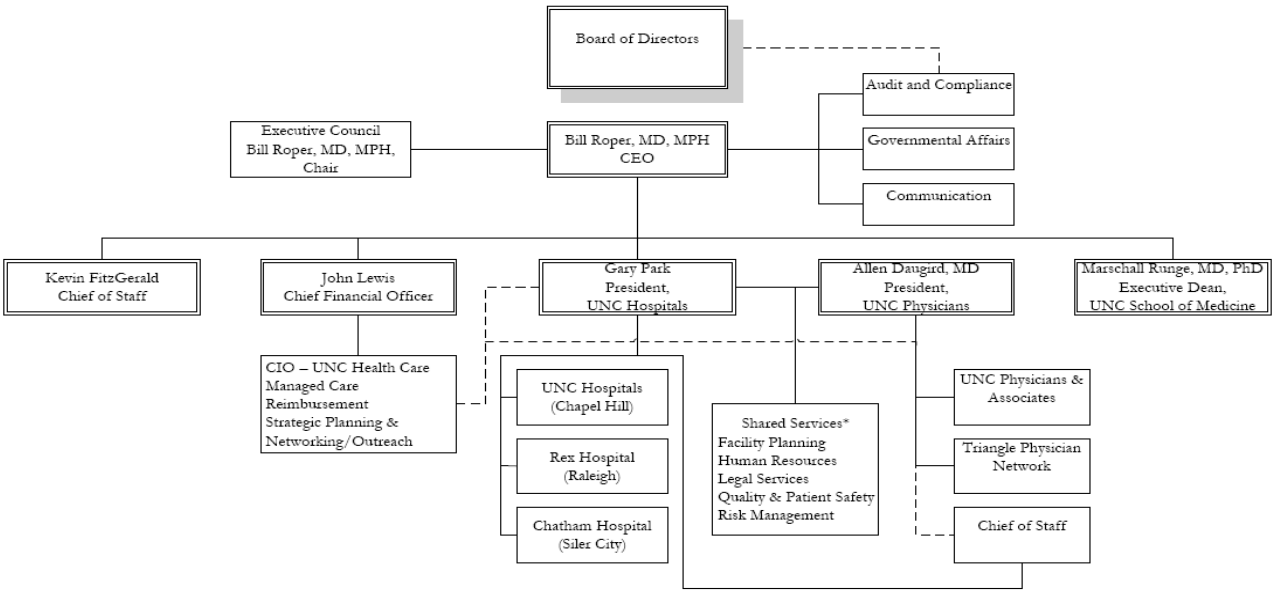
FY11 LEASE ACTIVITY

Location	Square footage	Program	Activity	Improvement
Orange County (Carrboro, NC)	17,654	Carolina Insutitute for Developmental Disabilities	New lease	Space to accommodate clinical trials research labs
Orange County (Chapel Hill, NC)	6,000		New lease	Space to accommodate clinical trials research labs
Durham County (Durham, NC)	933	Nephrology	New lease	Space to accommodate diabetes & endocrine clinic - Highgate
Orange County (Chapel Hill, NC)	16,810	OB/GYN	New lease	19 Apartments for OB/GYN Horizons program
Wake County (Raleigh, NC)	123	OB/GYN	New lease	Clinic Space within REX Cancer Center
Orange County (Chapel Hill, NC)	5,150	OB/GYN	New lease	7 Apartments for OB/GYN Horizons program
Dare County (Nags Head, NC)	548	Oncology	New lease	Space at Outer Banks Hospital to accommodate UNC Navigators
Orange County (Chapel Hill, NC)	2,476	Oncology	New lease	Comprehensive Cancer Support Program
Orange County (Chapel Hill, NC)	1,451	Oncology	New lease	Comprehensive Cancer Support Program
Orange County (Chapel Hill, NC)	8,018	Orthopedics	New lease	Space to accommodate Orthopaedic Prompt Care - Carolina Pointe
Orange County (Chapel Hill, NC)	208	Orthopedics	New lease	Space to accommodate Orthopaedic DME storage
Orange County (Chapel Hill, NC)	3,183	Ophthalmology	New lease	Space to accommodate UNC Eye Center - Chapel Hill North
Person County (Roxboro, NC)	2,500	Ophthalmology	New lease	Space to accommodate clinic operations in Roxboro, NC
Chatham County (Siler City, NC)	1,456	Ophthalmology	New lease	Space to accommodate UNC Eye Center - Siler City
Chatham County (Siler City, NC)		Ophthalmology	New lease	Lease human asset to provide clinal services - Siler City
Orange County (Carrboro, NC)	7,837	Aesthetic Surgery	New lease	Space to accommodate Aesthetic Clinic in Chapel Hill, NC
Guilford County (Greensboro, NC)	1,665	Pediatrics	New lease	Space to accommodate Pediatric Cardiology at Moses Cone Hospital
New Hanover County (Willmington, NC)	2,250	Pediatrics	New lease	Space to accommodate Pediatric Cardiology Clinic in Wilmington
Orange County (Carrboro, NC)	4,000	Psychiatry	New lease	Space to accommodate Department of Psychiatry programs at Carr Mill Mall
Orange County (Chapel Hill, NC)	2,972	Psychiatry	New lease	Space to accommodate Department of Psychiatry programs

Appendix XIV UNC HEALTH CARE ORGANIZATIONAL CHART



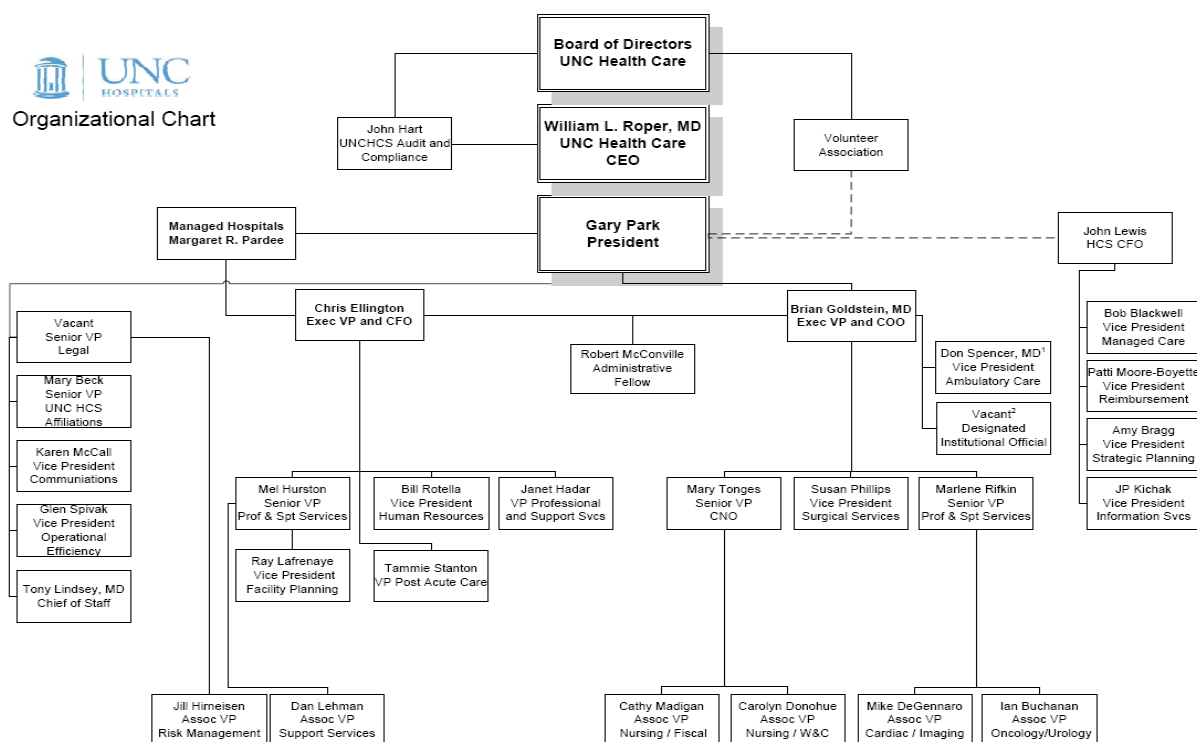
Organizational Chart
July 1, 2011



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

Appendix XV

UNC HOSPITALS ORGANIZATIONAL CHART

¹ Reporting Relationship also to P&A² Reporting relationship also to UNC SOM

Gary L. Park
Gary L. Park, President

July, 2011