PERFORMANCE AUDIT REPORT

The KU Medical Center and KU Hospital: Reviewing Selected Financial Issues

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
October 2007

07PA27

Legislative Post Audit Committee
Legislative Division of Post Audit

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LEGISLATIVE DIVISION OF POST AUDIT

800 SW Jackson
Suite 1200
Topeka, Kansas 66612-2212
Telephone (785) 296-3792
FAX (785) 296-4482
E-mail: LPA@lpa.state.ks.us
Website:
http://kslegislature.org/postaudit
Barbara J. Hinton, Legislative Post Auditor

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LEGISLATURE OF KANSAS

LEGISLATIVE DIVISION OF POST AUDIT

800 SOUTHWEST JACKSON STREET, SUITE 1200
TOPEKA, KANSAS 66612-2212
TELEPHONE (785) 296-3792
FAX (785) 296-4482
E-MAIL: lpa@lpa.state.ks.us

October 23, 2007

To: Members, Legislative Post Audit Committee

Representative Peggy Mast, Chair	Senator Nick Jordan, Vice Chair
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This report contains the findings, conclusions, and recommendations from our completed performance audit, *KU Medical Center and KU Hospital: Reviewing Selected Financial Issues*. The report also contains an appendix providing information about some commitments to faculty members at the Medical Center.

This report includes a recommendation for the Medical Center to report information from its 2007 consolidated financial statement to the Legislative Post Audit Committee before the 2008 session.

We would be happy to discuss the findings presented in this report or any other items with any legislative committees, individual legislators, or other State officials. These findings are supported by a wealth of data, which may allow us to answer additional questions about the audit findings or to further clarify the issues raised in the report.

Barbara J. Hinton
Legislative Post Auditor

READER'S GUIDE

Get the Big Picture

Read these Sections and Features:

1. **Executive Summary** - an overview of the questions we asked and the answers we found.

2. **Conclusion** and **Recommendations -** are referenced in the Executive Summary and appear in a box after each question in the report.

3. **Agency Response** - also referenced in the Executive Summary and is the last Appendix.

Helpful Tools for Getting to the Detail

- In most cases, an "**At a Glance**" description of the agency or department appears within the first few pages of the main report.
- **Side Headings** point out key issues and findings.
- **Charts/Tables** may be found throughout the report, and help provide a picture of what we found.
- **Narrative text boxes** can highlight interesting information, or provide detailed examples of problems we found.
- **Appendices** may include additional supporting documentation, along with the audit **Scope Statement** and **Agency Response(s)**.

Legislative Division of Post Audit
800 SW Jackson Street, Suite 1200, Topeka, KS 66612-2212
Phone: 785-296-3792 E-Mail: lpa@lpa.state.ks.us
Web: www.kslegislature.org/postaudit

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Overview of the KU Hospital and KU Medical Center

Before 1998, the KU Hospital and the KU Medical Center were both part of the University of Kansas. The Legislature created a separate Hospital Authority in 1998 to improve the Hospital's financial viability. The Hospital is still the teaching hospital for the Medical Center, but is no longer part of the University and is not a State agency. Since it was spun off from the Medical Center, the Hospital's situation has improved significantly—both revenues and inpatient numbers are up.

The Hospital and Medical Center remain intertwined. They have overlapping interaction with students, residents, physicians, faculty, facilities, and the like. Further, although the two entities are funded separately, certain funds flow between the two, such as Medicare payments for residency programs, and payments for services the two entities purchase from one another.

Question 1: Does the Medical Center Have Sufficient Cash Flow To Cover Its Major Financial Obligations and Employment Agreements?

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We saw no evidence the Medical Center was having trouble covering its ongoing operations. *To analyze the Medical Center's financial strength, we reviewed financial statements for fiscal years 2004-2006 (the latest year available), focusing on current assets and liabilities for ongoing operations. Between 2004 and 2006, those assets increased by about 31%, while liabilities increased by 13%, and cash balances increased by 10%. The ratio of those assets to liabilities also increased; in fiscal year 2006, for every dollar the Medical Center owed for ongoing operations, it had $1.50 in cash or near-cash assets to cover those costs.*

..... page 12

The School of Medicine has recorded about $79 million in commitments to faculty since 1999, and appears to have been able to meet most commitments. *These commitments are promises made to department chairs it's recruiting. Commitments typically are made for faculty salaries, administrative salaries, start-up costs, and infrastructure within the department. The median commitment amount was $580,000, which often is spread over several years.*

Funding for these commitments can come from a variety of sources, but much of it has come from the KU Endowment Association, which includes contributions from Kansas University Physicians, Inc., (KUPI), and the Medical Center's Research Institute. As of August 2007, the School of Medicine had paid 61% of the total amount committed to department chairs since 2003. The School typically pays $9 million to $12 million per year toward commitments.

Six of the seven department chairs we surveyed didn't have any major complaints about their School of Medicine commitments. One department chair reported being unhappy because the School of Medicine didn't allow that chair to hire faculty as promised, and it took a long time to get promised equipment.

The Medical Center has a $247 million, five-year capital plan with identified funding sources. *The six projects in the Medical Center's capital plan include deferred maintenance, new facilities, and renovations. Funding sources already have been identified for all these projects, and include revenue bonds, Bioscience Authority funding, and State General Fund appropriations.* ..... page 18

Officials recently unveiled plans to spend $800 million over 10 years to expand research. *The plan calls for new faculty and additional square footage. Medical Center officials hope to fund this vision partially through an affiliation with St. Luke's Hospital. Officials also are trying to find other sources of funding; possible sources include State appropriations, Johnson County Research Triangle tax, federal moneys, and Bioscience Authority funding.* ..... page 19

Question 1 Conclusion ..... page 21

Question 1 Recommendations ..... page 21

Question 2: How Has the Money the Legislature Appropriated for the Medical Center's Cancer Center Been Spent?

The KU Cancer Center is an umbrella organization formed to coordinate cancer research and care in Kansas and western Missouri. *Other entities involved include the Midwest Cancer Alliance, Stowers Institute, and the KU Hospital. The KU Cancer Center is working toward designation from the National Institutes of Health as a Cancer Center and then as a Comprehensive Cancer Center. The benefits of this designation include:* ..... page 22

- *a grant of up to $1 million annually*
- *increased ability to recruit and retain top researchers, who in turn can increase research funding*
- *easier patient access to advanced care*
- *easier physician access to clinical trial information.*

The Legislature appropriated $5 million to the Cancer Center for both fiscal years 2007 and 2008. *These appropriations didn't specify how the moneys were to be spent. At the time, Medical Center officials indicated the funding would be used for research, drug discovery, trials and outreach, and administration.* ..... page 24

In fiscal year 2007, the Cancer Center spent 45% of its appropriation on research; most funding went to pay salaries. *Its* ..... page 25

actual spending in each category listed above was very close to what Medical Center officials had told legislators in 2006. More than $4 million of the $5 million appropriation for fiscal year 2007 was spent on salaries, mostly for researchers and professors.

For fiscal year 2008, the Cancer Center projects it will spend 16% of its $5 million appropriation on research. *The $5 million State appropriation makes up about 43% of the Center's total funding for fiscal year 2008. Overall, about 43% of the Cancer Center's total budget from all sources for both fiscal year 2007 and 2008 was for research.* ..... page 26

Question 2 Conclusion ..... page 26

Question 3: Was the Hospital's Separation Agreement with the Former CEO Appropriate and Allowable?

The Hospital Authority executed a $1.8 million separation agreement with the former Chief Executive Officer. *The Chairman of the Board announced at the Board's meeting on March 19, 2007, that he'd received a letter or resignation from the former Chief Executive Officer effective June 30. Under the separation agreement, the Hospital agreed to pay her $1.8 million upon her departure. In exchange for this compensation, the agreement spelled out ongoing responsibilities the former CEO agreed to perform and various concessions she agreed to make. These include a non-compete clause and an agreement to provide consultation services.* ..... page 27

Nothing prohibited the Hospital Board from spending this amount for the former CEO's separation package. *As an independent instrumentality of the State, the Hospital's employees aren't State employees, and the Hospital isn't subject to State spending or purchasing laws. Although there was little hard information we could review or report on (some of the information we reviewed is confidential), we concluded the separation agreement didn't appear to be out of line, assuming the former CEO carries out the additional responsibilities outlined in the agreement.* ..... page 29

Question 3 Conclusion ..... page 30

Question 4: Was the Hospital's Purchase of an Electronic Medical Records System Appropriate and Allowable?

The Hospital contracted for a medical records system projected to cost about $50 million over five years. *The Hospital hired a consultant to help it conduct a needs assessment, then contracted with the same consultant to help it find a vendor. Three vendors' proposals were evaluated—Epic, Cerner, and Eclipsys. After an extensive process to evaluate the software, the Board chose to purchase a system from Epic with a five-year total cost of ownership of approximately $50 million.* ..... page 31

This audit was conducted by Chris Clarke, Melissa Doeblin, Allan Foster, Jill Shelley, and Amy Thompson. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Chris at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.

KU Medical Center and KU Hospital: Reviewing Selected Financial Issues

Before 1998, the University of Kansas Medical Center included both a hospital and a teaching/research facility. During the 1998 legislative session, the Legislature separated those functions and created a separate University of Kansas Hospital Authority to operate the University of Kansas Hospital.

The Medical Center now includes only the education/research function encompassing the Schools of Medicine (on campuses in both Kansas City and Wichita), Nursing, and Allied Health, as well as a graduate school. The Medical Center remained under the jurisdiction of the University of Kansas; the Executive Vice Chancellor of the Medical Center reports directly to the Chancellor of the University of Kansas.

The Medical Center has been working to win certification from the National Cancer Institute as one of the country's premier cancer centers. Obtaining the designation involves developing new treatments and drugs, increasing participation in clinical trials, and attracting top-rated doctors and scientists. The Medical Center also is pursuing an affiliation with St. Luke's Hospital in Kansas City, Missouri. The Legislature has made special appropriations for $5 million for both fiscal years 2007 and 2008 for the Medical Center's Cancer Center.

Recently, legislators expressed concerns about financial issues related to both the Medical Center and the Hospital. These include whether the Medical Center has sufficient cash flow to cover its current and future financial obligations and commitments made in employment agreements, how State appropriations for the Cancer Center have been spent, and whether particular expenditures made by the Hospital Authority are allowable and appropriate.

This performance audit answers the following questions:

1. **Does the Medical Center have sufficient cash flow to cover its major financial obligations and employment agreements?**

2. **How has the money the Legislature appropriated for the Medical Center's Cancer Center been spent?**

3. **Has the Hospital Authority's spending for certain items been appropriate and allowable?**

For reporting purposes, we've split Question 3 into two questions. One relates to the Hospital granting a separation package to the former CEO. The other relates to the Hospital's purchase of an electronic medical records system.

To answer these questions, we collected information from the Medical Center about its expenditures, commitments to employees, and sources of funding. We also interviewed Medical Center officials and some faculty members about Cancer Center expenditures and commitments the Medical Center has made to faculty, and examined documentation related to the Medical Center's expenditures.

We collected information from the Hospital about payments it has made as part of the former CEO's separation package, expenditures it has planned for a new medical information system, and Hospital physician and employee ratings of proposed medical information systems. We also interviewed Hospital officials about the separation package and the medical information system purchase, and examined documentation related to the Hospital's expenditures.

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in ***Appendix A.***

In conducting this audit, we followed the applicable government auditing standards set forth by the U.S. Government Accountability Office except that, because of time constraints we did only limited testwork of the faculty commitment data provided by the Medical Center. As a result of our limited testwork, we noted that the faculty commitment data used throughout the audit may not be completely accurate. Those inaccuracies would tend to understate the total value of the Medical Center's faculty commitments and payments towards those commitments. It's unlikely any inaccuracies would be large enough to affect our overall findings and conclusions.

Our findings begin on page 9, following a brief overview.

Before 1998, the University of Kansas Medical Center provided education through its Schools of Medicine, Nursing, and Allied Health, and operated a hospital on the Kansas City campus. The KU Hospital provided general and specialized patient services, and served as a major teaching and research facility. Both entities were part of the University of Kansas.

The Legislature Created a Separate Hospital Authority In 1998 To Improve the Hospital's Financial Viability

By 1998, the KU Hospital was in financial trouble and had other serious problems, as described below:

- **financial problems.** The Hospital's revenue had been declining, and officials projected severe financial challenges in the near future.
- **a drop in the number of patients.** According to Hospital records, in just three years, the number of patients served by the Hospital had dropped 16%, from 109,000 in 1993 to 92,000 in 1996.
- **heart transplant program problems.** Reports in 1995 revealed that the Hospital's heart transplant program had refused donor hearts while continuing to accept transplant patients. As a result, the Hospital closed its transplant program in 1995.
- **lack of timely access to capital.** Before 1998 the Hospital needed legislative approval for bonded indebtedness. This made it difficult for the Hospital to obtain financing for strategic investments in programs or facilities as quickly as its private competitors.

In 1996, the Board of Regents hired consultants to review the Hospital's situation and report back to the Board with recommendations for addressing such problems. The consultants concluded that being regulated as a government agency had reduced the Hospital's ability to compete with non-regulated providers in four areas: capital financing and acquisition, human resources management, procurement practices, and information systems development.

The consultants recommended that the Hospital be reorganized—either as a public authority or a private corporation—to help it adapt to heightened competition in the local healthcare market and improve its ability to compete.

During legislative hearings on reorganizing the Hospital, both the Chair of the Board of Regents and KU Chancellor testified in favor of creating a public authority. The Board Chair noted that, by enhancing its competitive position, the Hospital would be able to deliver on its mission of supporting the Medical Center's education and research activities.

The Chancellor noted that having University and Medical Center officials serving as ex-officio members of the Hospital Authority

Board would maintain a "direct tie" between the Hospital and the University /Medical Center, and would ensure that the educational mission was always honored.

The 1998 Legislature created the Kansas Hospital Authority as an independent instrumentality of the State. The Authority is governed by a 19-member board of directors. Six members are ex-officio voting members and include four University/Medical Center officials—the Chancellor of the University of Kansas, the Executive Vice Chancellor of the Medical Center, the Executive Dean of the School of Medicine, and the Dean of the School of Nursing. The other two ex-officio members are the Hospital's President and Chief of Staff. The remaining 13 members are appointed by the Governor, subject to confirmation by the Senate.

The statute specified that the mission of the Hospital was to "… facilitate and support the education, research and public service activities of the University of Kansas Medical Center and its health sciences schools, to provide patient care and specialized services not widely available elsewhere in the State and to continue the historic tradition of care by the University of Kansas Hospital to medically indigent citizens of Kansas."

Although the Hospital retained the University of Kansas name, it's no longer part of the University or the Medical Center. The 1998 legislation clearly stated the Hospital wasn't a State agency, its employees weren't employees of the State, and it wasn't subject to State purchasing laws. The Hospital receives no State appropriations. As an independent instrumentality of the State, the Hospital:

- has more independent authority than State agencies
- has the power to provide its own funding outside of the State Treasury
- isn't required to submit budgets to the Governor or Legislature
- isn't required to follow State purchasing regulations, hiring and promotion regulations, or other requirements for State agencies

Further, the State and the University of Kansas are no longer responsible for the Hospital's debt.

Since it was spun off from the Medical Center, the Hospital's situation has improved significantly. In 2006, Hospital officials hired one of the original consultants to provide an updated assessment of the Hospital's situation. This consultant was formerly the president of Lash Group, the firm that produced the 1997 report entitled, *The Need for Governance/Ownership Change at KUH.*

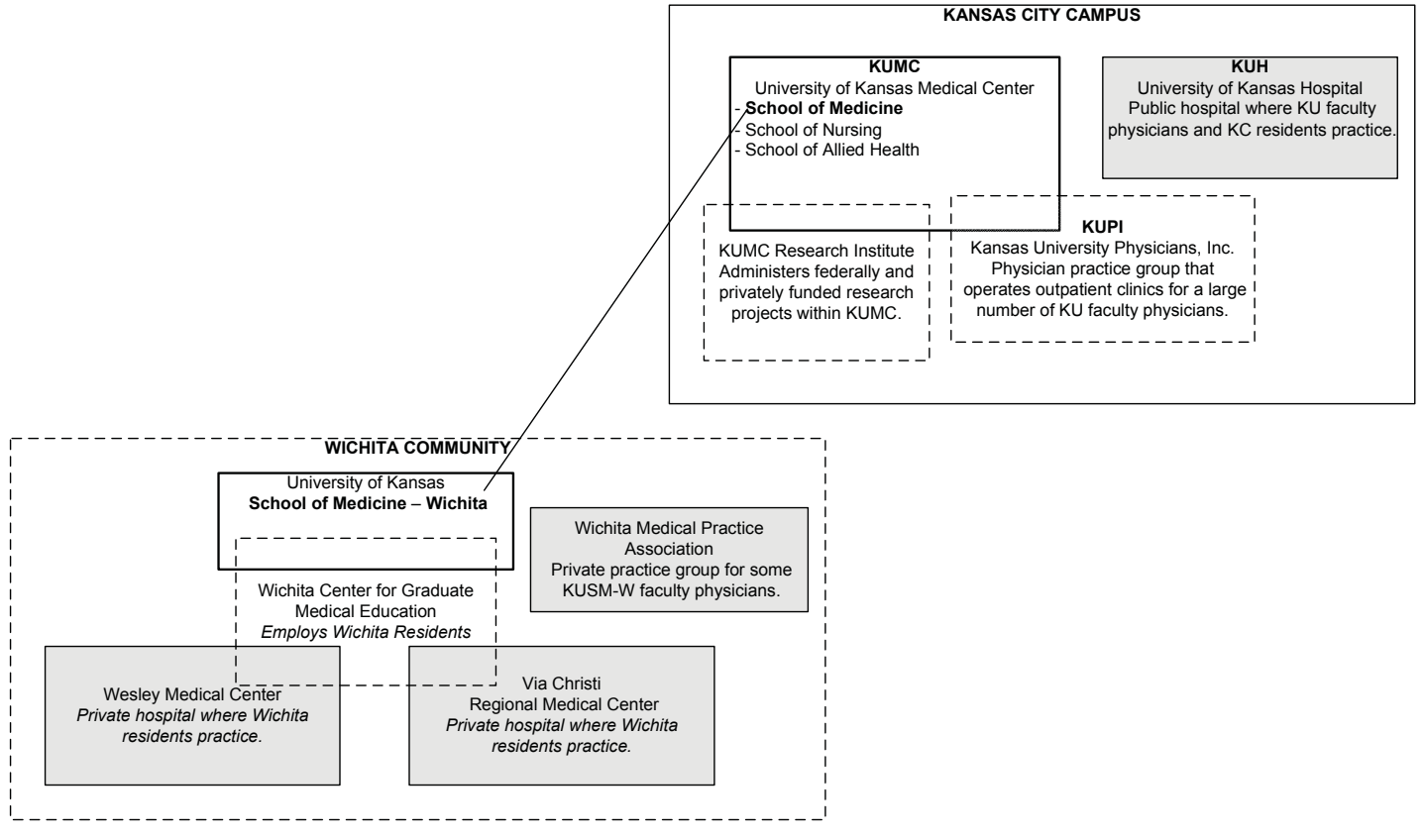
The updated report provided the following information:

- the Hospital's total revenues had grown from about $190 million in fiscal year 1998 to about $540 million in fiscal year 2006
- the number of inpatient days at the Hospital had increased from about 92,000 in fiscal year 1996 to more than 110,000 in fiscal year 2006, and the volume of inpatients had grown from about 14,000 in fiscal year 1996 to nearly 20,000 in fiscal year 2006
- the Hospital had reopened its heart surgery program
- the Hospital's capital expenditures had increased from $46 million during fiscal years 1993-1999 to $324 million during fiscal years 2000-2006

The Hospital and Medical Center Remain Intertwined

Although the Hospital and the Medical Center now are separate legal entities, they have overlapping interaction with students, residents, physicians, faculty, facilities, and the like. ***Figure OV-1*** summarizes those relationships at a high level. The listing on the next page shows the main groups involved in both entities.

Figure OV-1
KU Hospital and Medical Center (Kansas City and Wichita)



Source: LPA Analysis of KUMC and KU Hospital Relationship

The Hospital is the primary teaching hospital for the Medical Center in Kansas City. The Medical Center also has affiliation agreements with two other hospitals in Kansas City: Children's Mercy and Veteran's Administration Hospitals. Via Christi, and Wesley Medical Center serve as the primary teaching hospitals for the medical residents in Wichita.

Kansas University Physicians, Inc., (KUPI) is the Faculty Practice Plan for the physicians employed by the foundations that serve as both faculty for the Medical Center and medical staff for the Hospital. The Hospital has a "closed" staff, which means that only physicians who are faculty at the Medical Center are allowed to practice at the Hospital.

KU Medical Center—Kansas City campus houses the Schools of Medicine, Nursing, and Allied Health. The School of Medicine has students for four years of Medical School. The Kansas City campus operates its own residency program, and those residents are employees of the Medical Center. The Kansas City campus provides most of the administrative structure for the Medical Center as a whole, including executive management, accounting, human resources, and the like.

KU School of Medicine—Wichita campus (KUSM-W) was established by the Board of Regents in 1971 as a community-based component of the School of Medicine. The Wichita campus is affiliated with several local hospitals where students and medical residents are able to observe and treat patients. The Wichita campus is different from the Kansas City campus in a number of ways. For example, it serves only 3rd- and 4th-year medical students, and doesn't have Schools of Nursing or Allied Health. [***Figure OV-2*** shows the number of students and medical residents at the two campuses.] The Wichita campus also contracts with the Wichita Center for Graduate Medical Education (WCGME) to operate its residency program, and those residents are employees of WCGME.

Wichita Center for Graduate Medical Education (WCGME) is a non-profit corporation formed by collaborative efforts of the Medical Center in Wichita, Via Christi, and Wesley Medical Center. It employs and pays the medical residents in Wichita.

Medical Residents/Residency is a stage of postgraduate medical training in a primary care or medical specialty area. Medical residents have received their medical degrees, and spend their residency period caring for hospitalized or clinic patients, mostly under the supervision of more senior physicians.

Figure OV-2
Number of Students and Residents at Each Campus
Fall 2007

Number of students and residents:	
Kansas City Campus:	
School of Medicine	
Graduate	209
Medical Students	583
All Other[1]	86
School of Nursing	627
School of Allied Health	558
Residents	418
Other[2]	8
TOTAL, KC Campus	**2,489**
Wichita Campus:	
School of Medicine	
Graduate	40
Medical Students	105
All Other[3]	7
Residents	273
Other[4]	4
TOTAL, Wichita Campus	**429**
TOTAL, Both Campuses	**2,918**

[1] 60 Visiting Trainees, 24 MD/PhD Students, and 2 Clinical Psychology Pre-Doctoral Internship Students

[2] 8 Lawrence students taking at least half of their credit hours in Kansas City

[3] 7 Visiting Trainees

[4] 4 Nursing students taking at least half of their credit hours at Wichita

Source: Medical Center data

Although the Hospital And Medical Center Are Funded Separately, Certain Funds Flow Between the Two

The Medical Center is part of the University of Kansas, and as such receives some State appropriations. Other funding sources for the Medical Center can be summarized as follows:

- Hospital support revenue—funds provided by affiliated hospitals
- Federal support—primarily grants
- Tuition and fees

- Practice Plan revenue—revenues physicians and other providers generate from seeing patients
- Gifts/Endowment Fund revenue
- Payment from the Hospital for services it buys from the Medical Center (parking, utilities, etc)

The Hospital receives no State appropriations. Its funding sources can be summarized as follows:

- Insurance payments for services rendered, including Medicaid and Medicare
- Patient payments for services rendered
- Gifts/Philanthropy
- Medicare and Medicaid funding for the residency programs
- Payments from the Medical Center for services it buys from the Hospital (uniforms, office space, etc)

Some Medicare funding flows through the Hospital to the Medical Center. Every hospital that trains residents in an approved residency program is entitled to receive Medicare's direct graduate medical education payment, also known as DME. That payment is intended to cover the direct costs of training residents—such as residents' salaries, teaching physicians' salaries, and related overhead expenses.

The amount of DME paid is unique to each hospital, and was based on a formula calculated by the federal Centers for Medicare and Medicaid Services' predecessor in the 1980s. The amount periodically is updated by an inflation factor.

Teaching hospitals also receive an indirect medical education adjustment from Medicare, also known as IME. This payment is intended to recognize the high costs of inpatient care that teachings hospitals have, compared to non-teaching hospitals. The IME adjustment is an additional payment the hospital receives for each inpatient stay, and is based on the ratio of interns and residents to hospital beds.

At the Kansas City campus, the Medical Center and Hospital have a negotiated agreement specifying that the Hospital would pay the Medical Center only the direct funds (DME) it receives from Medicare. In Wichita, the two hospitals affiliated with the Medical Center's Wichita campus contribute some portion of both the direct and indirect graduate medical education funds they receive from Medicare to WCGME, which runs the residency program in Wichita.

The At-a-Glance boxes on the next page show the major funding and expense categories for both the Medical Center and the Hospital.

University of Kansas Medical Center
AT A GLANCE

Governed By: Board of Regents and University of Kansas.

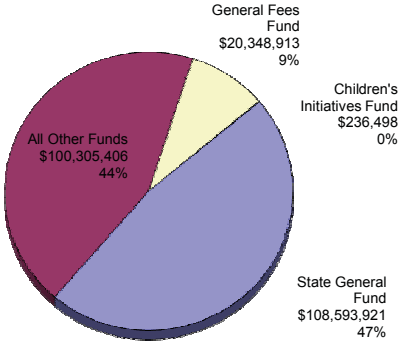
Staffing: The Medical Center has 2,482 full-time-equivalent positions.

Budget: The Medical Center's major funding comes from General Fund appropriations. The Medical Center also receives moneys from other sources, including federal grants and the Children's Initiatives Fund. For fiscal year 2006, the Medical Center took in and spent about $229.5 million as shown below. Most of these moneys were for salaries and wages and contractual services.

FY 2006 Expenditures

Type	Amount	% of Total
Salaries & Wages	$181,289,244	79%
Contractual Services	$26,281,391	11%
Other Assistance	$9,759,247	4%
Commodities	$6,755,227	3%
Capital Outlay & Improvements	$4,842,126	2%
Debt Service Interest	$557,503	0%
Aid to Local Units	$0	0%
Total Expenses:	**$229,484,738**	**100%**

Sources for Funding for Expenditures



Total Funding: **$229,484,738**

Source: Kansas Legislative Research Department, Budget Analysis, Vol. 1, FY 2008.

University of Kansas Hospital Authority
AT A GLANCE

Governed By: A 19-member board of directors made up of 6 ex-officio positions and 13 public members.

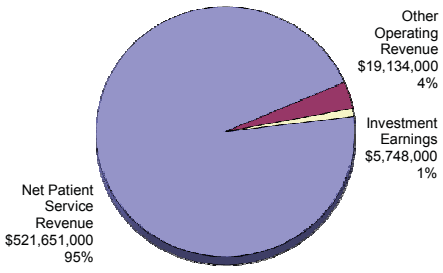
Staffing: The Hospital has 3,345 full-time-equivalent positions.

Budget: More than 95% of the Hospital's revenue is from providing patient services. For fiscal year 2006, the Hospital took in about $546.5 million in revenue and spent about $474.5 million. The Hospital's fiscal year 2006 revenue number includes $18.6 million of Medicaid and $5.5 million of Medicare payments for prior fiscal years. After excluding the prior year payments, the Hospital's fiscal year 2006 revenue exceeded expenses by $47.9 million. Most of the Hospital's $474.5 million in expenditures were for personnel and supplies.

FY 2006 Expenditures

Type	Amount	% of Total
Salaries & Wages, Benefits & Contracted Labor	$233,880,000	49%
Supplies	$114,191,000	24%
Other Operating Expenses	$54,470,000	11%
Purchased Services	$44,756,000	9%
Depreciation & Amortization	$21,254,000	4%
Interest Expense	$5,255,000	1%
Other non-Operating	$645,000	0%
Total Expenses:	**$474,451,000**	**100%**

FY 2006 Revenue



Total Revenue: **$546,533,000**

Source: University of Kansas Hospital Authority 2006 Financial Statements

Question 1: Does the Medical Center Have Sufficient Cash Flow To Cover Its Major Financial Obligations and Employment Agreements

ANSWER IN BRIEF:

We saw no evidence to indicate the Medical Center was having trouble covering its ongoing operations. From 2004-2006, its current assets for ongoing operations increased by about 31%, its current liabilities for ongoing operations increased by 13%, and its cash balances and ratios looked healthy. The School of Medicine has made commitments totaling $79 million to department chairs since 1999. Such commitments generally are for several-year periods. The Medical Center has paid about 61% of the commitments made since 2003, mostly with KU Endowment and Research Institute funds. It appears to have been able to meet most commitments. Over the next five years, the Medical Center has committed nearly $250 million to capital expenditures. These plans are approved by the Board of Regents and the Legislature and have identified funding sources. Finally, officials recently unveiled a proposal to spend $800 million over 10 years to expand research. Funding sources haven't been fully identified; possible sources discussed have included moneys from an affiliation with St. Luke's Hospital as well as contributions from the Kansas City area. These and related findings are discussed in more detail in the sections that follow.

We Saw No Evidence The Medical Center Was Having Trouble Covering Its Ongoing Operations

Because most State agencies operate primarily on a budgetary basis, they don't prepare financial statements or future cash-flow projections. The Medical Center does prepare financial statements, but not future cash-flow projections.

These financial statements include the Student Union Corporation, the University of Kansas Medical Center Research Institute, KU HealthPartners, Inc., and Kansas University Physicians, Inc. These entities are component units that have enough of their governance in common with the Medical Center that it may significantly influence them.

To analyze the Medical Center's financial strength, we reviewed those financial statements for fiscal years 2004, 2005, and 2006 (2007 financial statements won't be ready until the end of October 2007). Because our focus in this section was on the Medical Center's ability to cover the costs of its ongoing operations, we did the following:

- Instead of looking at total assets and liabilities, we focused on the "current" assets (cash, cash equivalents, and other liquid assets) and "current" liabilities (debts coming due within a year) in the Medical Center's financial statements.

- Because current assets and liabilities still can include dollars related to capital outlay projects, which aren't part of ongoing operational costs, we deducted those items that we could readily tell from the financial statements were included in current assets and liabilities but were related to capital outlay projects. That involved excluding from current assets the bond proceeds being held by the Kansas Development Finance Authority on the Medical Center's behalf, and excluding from current liabilities the bonds payable for the current year. These adjustments should make our comparisons in this section more meaningful.

The reader also should be aware that the Medical Center's commitments to department chairs aren't included in its financial statements (nor should they be, from an accounting standpoint). Those commitments are discussed in the next section of this report.

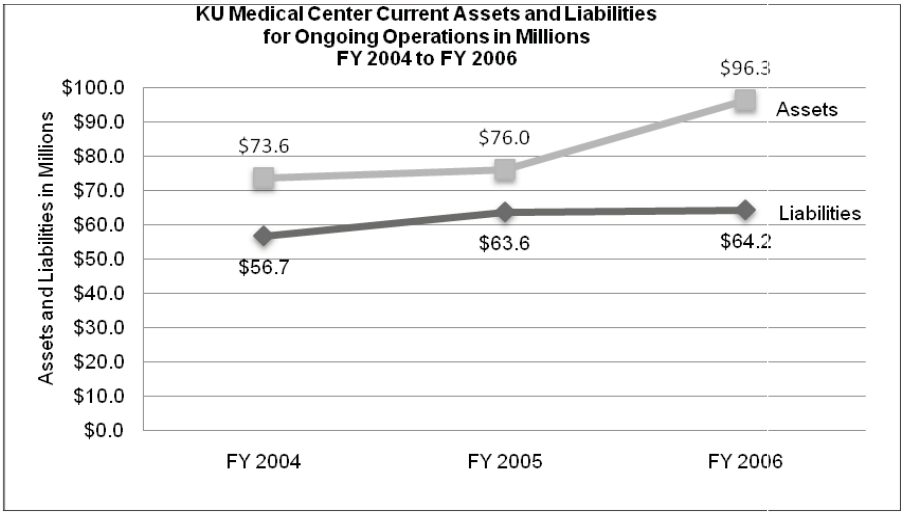
From 2004 to 2006, the Medical Center's current assets for ongoing operations increased more than its current liabilities for ongoing operations, and its cash balances and ratios looked healthy. As the top section of ***Figure 1-1*** shows, during that period the Medical Center's current assets for ongoing operations increased, from about $74 million to $96 million, or by 31%. Much of that increase occurred in fiscal year 2006, and was related to a sharp rise in the Research Institute's and Medical Center's reported short-term investment value, and to increases in the Medical Center's accounts receivable and grants receivable.

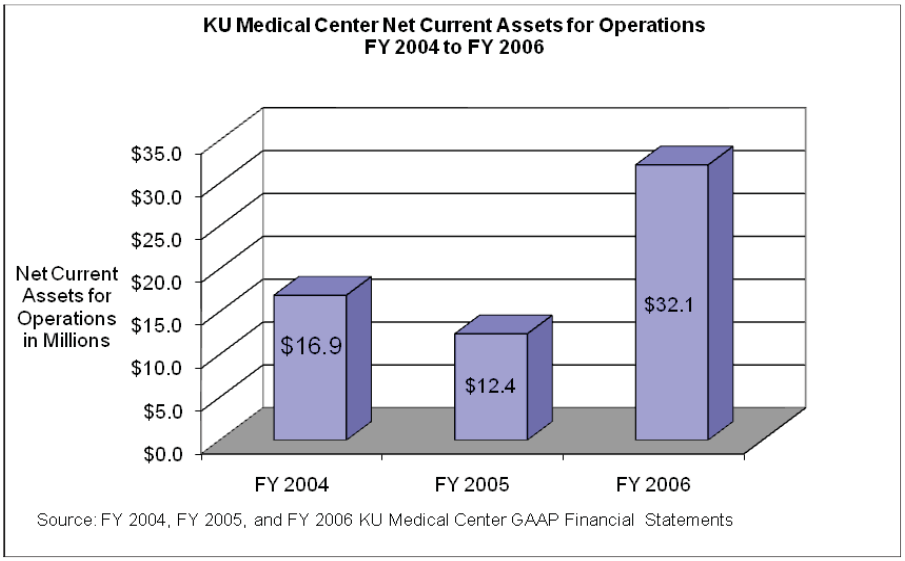
During that same period, the Medical Center's current liabilities for ongoing operations increased from about $57 million to $64 million, or by 13%.

The bottom section of ***Figure 1-1*** shows that the Medical Center's "net" current assets for ongoing operations (assets minus liabilities) increased from about $17 million in fiscal year 2004 to $32 million in fiscal year 2006.

Figure 1-2 shows that the Medical Center's ending cash balances increased by about 10% during the same time period, from about $53 million to $58 million. The Medical Center's ending cash balances represent approximately two months of its operating expenses.

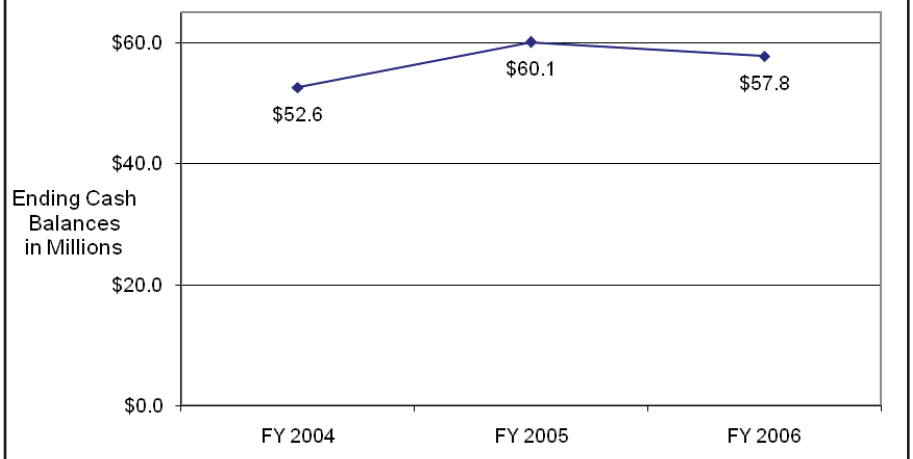
Figure 1-1





Source: FY 2004, FY 2005, and FY 2006 KU Medical Center GAAP Financial Statements

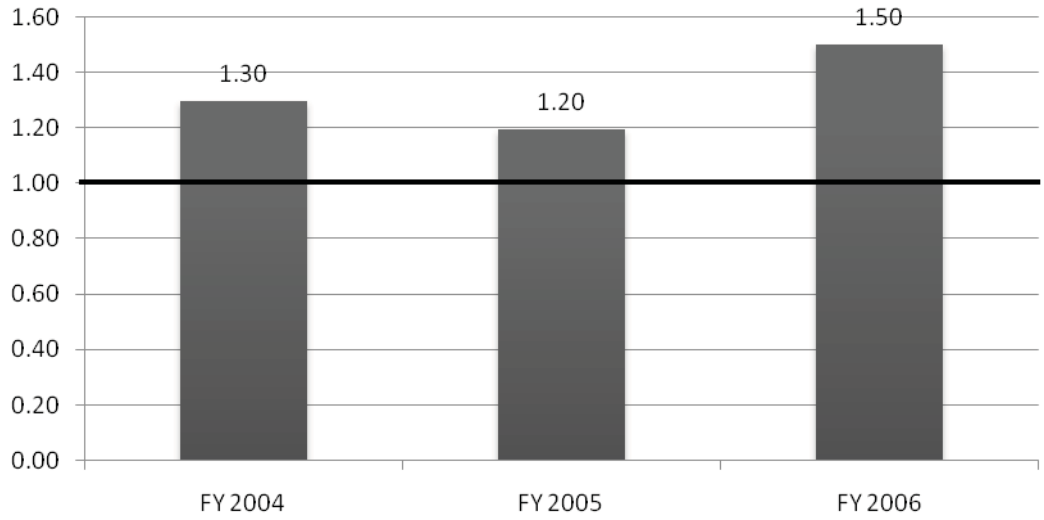
Figure 1-2
KU Medical Center Ending Cash and Cash Equivalent Balances
FY 2004 to FY 2006



Source: FY 2004, FY 2005, and FY 2006 KU Medical Center GAAP Financial Statements

In addition, ***Figure 1-3*** shows that the Medical Center's current ratio for ongoing operations increased over the three-year period (after dipping in fiscal year 2005). A ratio of more than one indicates an entity can pay off its obligations; the higher the ratio, the more liquid the entity is. The ratio in fiscal year 2006 was 1.5. That means that for every dollar the Medical Center owed, it had $1.50 in cash or near-cash assets to cover its ongoing operations.

Figure 1-3
KU Medical Center's Current Ratio for Ongoing Operations
FY 2004 to FY 2006



Source: LPA analysis of FY 2004, FY 2005, and FY 2006 GAAP Financial Statements

Finally, Hospital and Medical Center officials currently are working to establish a base level of support the Hospital would provide to the Medical Center. For fiscal year 2008, the estimated amount is $42.5 million, which is significantly higher than the Hospital's support payments in previous years ($20 million in 2006 and $27 million in 2007). These increased support payments from the Hospital should put the Medical Center in a stronger cash position in the future.

The School of Medicine Has Recorded About $79 Million in Commitments To Faculty Since 1999, And Appears To Have Been Able to Meet Most Commitments

The School of Medicine often makes specific promises to department chairs it recruits as a way of attracting them. These promises are detailed in "commitment" letters, and are intended to help a new department chair attract new faculty or revitalize departments.

Commitments typically are made for faculty salaries, administrative salaries, start-up costs, and infrastructure (such as operational support, renovations, or equipment), and may last for several years. For example, the School of Medicine may commit

to pay a portion of two new faculty members' salaries for three years, as well as to buy certain equipment for their laboratory. The School of Medicine also may make additional commitments beyond those it initially offers.

Eventually, departments are expected to generate their own funding to cover the on-going costs—such as faculty salaries—that are covered by the commitments. They typically use research or other grants, endowments, and clinical income to pay for these on-going expenses.

For a variety of reasons, the School of Medicine may not pay the full amount of the commitment. For example:

- although the moneys promised in commitments may go towards faculty within a department, the commitment is made to the department chair. Thus, if a department chair leaves, the commitment ends. Once a new department chair is hired, a new commitment would be negotiated.

- The department may find or receive a permanent source of funding for some items covered by the commitment before the end of the commitment period (such as funding for a faculty member's salary after his or her first year).

The Medical Center also may pay the department for more than the original amount committed. For example, we identified a total of $3.8 million in such overpayments during the period we reviewed.

The School of Medicine has records detailing a total of $79 million in commitments to 44 different departments since fiscal year 1999. We noted that the School's summary records sometimes were higher than the original commitment letters in the files because another formal commitment letter isn't created when the original commitment is increased. School officials told us their summary records contain the most up-to-date information; we couldn't verify that information.

The median amount of all 44 commitments was $580,000. A summary of these commitments is shown in ***Figure 1-4*** on the next page.

At least $64.4 million of the $79 million in commitments listed was made after the start of fiscal year 2003. The figure also shows that commitments increased significantly in fiscal years 2003, 2004, and 2006, but tapered off in fiscal year 2007. [For some commitments, we couldn't tell when they were made because they didn't have letters. A full listing of those commitments can be found in ***Appendix B***.]

Figure 1-4
Summary of Commitments to Department Chairs by the School of Medicine, by Fiscal Year As of August 2007

Department	Commitment Letter Date	Faculty Salaries	Start Up	Admin. Salaries	Infrastructure/ OOE Support	Total Committed	Total Paid (b)
FISCAL YEAR 1999							
Anatomy	7/22/1998	$232,020	$1,275,000	$0	$0	$1,507,020	$1,050,097 (a)
Microbiology	12/28/1998	$0	$1,231,000	$0	$0	$1,231,000	$25,000 (a)
Fiscal Year 1999 Totals		**$232,020**	**$2,506,000**	**$0**	**$0**	**$2,738,020**	**$1,075,097 (a)**
FISCAL YEAR 2000							
Psychiatry	8/30/1999	**$321,368**	**$30,000**	**$48,720**	**$0**	**$400,088**	**$182,065 (a)**
FISCAL YEAR 2001							
Neurology	7/19/2000	**$551,214**	**$2,071,000**	**$0**	**$110,000**	**$2,732,214**	**$678,881 (a)**
FISCAL YEAR 2002							
Family Med.	9/13/2001	$198,406	$662,592	$0	$75,000	$935,998	$569,904 (a)
Maternal Fetal Biology	6/25/2002	$111,280	$497,000	$0	$379,000	$987,280	$553,427 (a)
Fiscal Year 2002 Totals		**$309,686**	**$1,159,592**	**$0**	**$454,000**	**$1,923,278**	**$1,123,331 (a)**
FISCAL YEAR 2003							
Physiology	9/10/2002	$374,471	$2,420,000	$0	$10,217	$2,804,688	$2,384,351
Biochemistry	9/30/2002	$561,085	$3,520,000	$0	$711,656	$4,792,741	$1,860,458
IDDRC	11/6/2002	$0	$0	$0	$340,000	$340,000	$131,976
Pharmacology	11/26/2002	$1,095,207	$3,250,000	$0	$275,000	$4,620,207	$1,552,816
Ctr on Aging	12/13/2002	$0	$124,143	$0	$100,432	$224,575	$100,432
Fiscal Year 2003 Totals		**$2,030,763**	**$9,314,143**	**$0**	**$1,437,305**	**$12,782,211**	**$6,030,033**
FISCAL YEAR 2004							
Pathology	8/19/2003	$147,008	$300,000	$143,965	$89,900	$680,873	$347,338
Kidney Institute	10/28/2003	$367,204	$900,000	$95,760	$63,000	$1,425,964	$771,605
Internal Medicine	1/19/2004	$218,922	$0	$0	$25,664,529	$25,883,451	$24,535,843
Ctr for Biostat.	1/25/2004	$267,869	$0	$11,419	$175,136	$454,424	$164,467
Surgery-Neuro	6/16/2004	$1,182,340	$427,943	$146,500	$10,724	$1,767,507	$1,581,827
Fiscal Year 2004 Totals		**$2,183,343**	**$1,627,943**	**$397,644**	**$26,003,289**	**$30,212,219**	**$27,401,080**
FISCAL YEAR 2005							
History of Med.	8/16/2004	$73,929	$0	$44,113	$0	$118,042	$73,929
Otolaryngology	3/29/2005	$172,260	$477,480	$90,141	$15,000	$754,881	$291,078
Fiscal Year 2005 Totals		**$246,189**	**$477,480**	**$134,254**	**$15,000**	**$872,923**	**$365,007**
FISCAL YEAR 2006							
Radiology	7/19/2005	$265,091	$600,000	$0	$0	$865,091	$146,625
Pediatrics	7/29/2005	$499,581	$180,000	$0	$545,616	$1,225,197	$400,961
Anesthesiology	12/5/2005	$227,742	$0	$267,900	$340,000	$835,642	$715,641
OBGYN	12/22/2005	$1,828,871	$2,646,970	$0	$5,176,104	$9,651,945	$3,258,347
Ophthalmology	6/20/2006	$627,595	$4,804,566	$0	$2,273,379	$7,705,540	$676,124
Fiscal Year 2006 Totals		**$3,448,880**	**$8,231,536**	**$267,900**	**$8,335,099**	**$20,283,415**	**$5,197,698**
FISCAL YEAR 2007							
Hlth Pol./Mgmt	9/27/2006	**$255,420**	**$0**	**$0**	**$12,000**	**$267,420**	**$54,763**
Commitments Where the Date Wasn't Available							
20 Depts.	**Couldn't Tell**	**$1,727,230**	**$850,651**	**$1,701,426**	**$2,525,745**	**$6,805,052**	**$4,580,718 (a)**
Total Commitments		**$11,306,113**	**$26,268,345**	**$2,549,944**	**$38,892,438**	**$79,016,840**	**$46,688,673 (a)**

Source: School of Medicine commitment data
(a) Payments may be understated because payment data wasn't available before fiscal year 2003.
(b) Excludes additional payments made above the amount of the commitment.

Funding for these commitments can come from a variety of sources, but much of it has come from the KU Endowment Association, which includes contributions from KUPI, and the Medical Center's Research Institute. Our reviews showed that the following sources have been used to pay for commitments:

- **KU Endowment**. This is mainly support payments from KUPI's clinical revenue. It may also include private donations that may be restricted for certain purposes, such as an endowed professorship.

- **Research Institute**. A separate, but related legal entity that administers federally and privately funded research projects as well as clinical trials for the Medical Center. It provides a portion of grant funding that can be used to cover administrative expenses.
- **Research Overhead**. The portion of federal and other research grants that can be used to cover administrative expenses.
- **State Appropriations**. Moneys appropriated by the Legislature.
- **Other Sources**. Includes student fees and the Distinguished Medical Teaching Award from the KU Endowment.
- **Direct Medical Education**. Dollars the Hospital receives from Medicare and passes on to the Medical Center. This funding source was used before FY 2006.

We reviewed the funding sources for the five largest commitments the Medical Center has made. Almost two-thirds (63%) of the funding for these five commitments came from the KU Endowment Association. Another 18% came from the Research Institute.

Medical Center officials told us that, if an affiliation can be agreed on, St. Luke's may provide some funding for commitments in fiscal year 2008. The School of Medicine doesn't have formal plans that detail how it plans to fund commitments beyond fiscal year 2008.

As of August 2007, the School of Medicine had paid 61% of the total amount committed to department chairs since 2003. The reader should be aware that these figures may be somewhat understated, because School officials told us they weren't sure all payments made toward these commitments had been recorded before fiscal year 2003. They indicated they were most confident about the numbers reported for fiscal years 2003 and later.

Our review of total payments made each year towards the commitments showed that the School of Medicine typically paid $9 million to $12 million per year toward commitments. ***Figure 1-5*** on the next page shows the commitments by department, and how much the Medical Center has paid toward that commitment to-date. As of August 2007, the Medical Center planned to spend $7.3 million on commitments in fiscal year 2008. An additional $8.4 million may be paid towards commitments in 2008 if the Medical Center agrees to an affiliation with St. Luke's Hospital, receives additional support from the Hospital, or finds other sources.

The figure shows that some commitments are mostly fulfilled, while others have a long way to go before they are complete. That doesn't automatically indicate a problem. Officials told us commitments generally are designed to take at least three to five years to complete; during our review, we saw several with even longer timelines.

Figure 1-5
Amount Promised in Commitments Versus Amount Paid for Departments with Commitments from the School of Medicine Since FY 2003

New Departments with Commitments, Since FY 2003	Date of Commitment	Total Commitments	Total Paid As of August 2007	% Paid
Physiology	9/10/2002	$2,804,688	$2,384,351	85%
Biochemistry	9/30/2002	$4,792,741	$1,860,458	39%
IDDRC	11/6/2002	$340,000	$131,976	39%
Pharmacology	11/26/2002	$4,620,207	$1,552,816	34%
Center on Aging	12/13/2002	$224,575	$100,432	45%
Pathology	8/19/2003	$680,873	$347,338	51%
Kidney Institute	10/28/2003	$1,425,964	$771,605	54%
Internal Medicine	1/19/2004	$25,883,451	$24,535,843	95%
Center for Biostatistics	1/25/2004	$454,424	$164,467	36%
Surgery-Neuro	6/16/2004	$1,767,507	$1,581,827	89%
History of Medicine	8/16/2004	$118,042	$73,929	63%
Otolaryngology	3/29/2005	$754,881	$291,078	39%
Radiology	7/19/2005	$865,091	$146,625	17%
Pediatrics	7/29/2005	$1,225,197	$400,961	33%
Anesthesiology	12/5/2005	$835,642	$715,641	86%
Obstetrics and Gynecology	12/22/2005	$9,651,945	$3,258,347	34%
Ophthalmology	6/20/2006	$7,705,540	$676,124	9%
Health Policy and Management	9/27/2006	$267,420	$54,763	20%
Total for All Departments	**N/A**	**$64,418,188**	**$39,048,581**	**61%**

Source: School of Medicine commitment data

Further, some department chairs we spoke with said commitments to pay new faculty salaries and start-up costs may be delayed because nationwide shortages have made it difficult to hire new faculty.

And as noted earlier, some commitments may never be completely funded because the department chair may leave, permanent funding for ongoing costs may be found before the total commitment amount is paid, or the like.

We weren't able to assess the extent to which commitments "should have been" fulfilled because that would have required an in-depth review of the situation surrounding each line item in each commitment.

Six of the seven department chairs we surveyed didn't have any major complaints about their School of Medicine commitments. To determine whether department chairs thought

there had been a problem with the Medical Center's payments toward their commitments, we surveyed 7 of the 18 department chairs with commitments made after fiscal year 2003. We tried to select department chairs with large and small commitments, as well as commitments with both large and small percentages paid.

We talked with two department chairs whose commitments had been more than 50% funded. Neither one reported any problems. We also talked with five department chairs whose commitment had been less than 50% funded. Four of those department chairs didn't report having any problems with the level of the commitment paid to-date. Two of the four mentioned that payments had been delayed, but for good reasons:

- One indicated some funding for faculty salaries had been delayed because the department chair hadn't been able to hire a new faculty member. School of Medicine officials have told the department chair that funding would be available when a new faculty member was hired.

- The School of Medicine asked one department chair to wait until the next fiscal year to purchase additional costly lab equipment after the School of Medicine already had purchased an expensive piece of equipment. The department chair thought this was reasonable and was not upset by it.

One department chair reported being unhappy with the way the commitment had been handled. That department chair indicated the School of Medicine hadn't met its commitments because it hadn't allowed the chair to hire new faculty who would receive commitment moneys. In addition, this department chair reported it took a long time to get equipment needed for start-up.

The School of Medicine made about $3.8 million in "additional" payments toward commitments made in fiscal years 2003-2007. These additional payments are tracked separately. Additional payments weren't formal changes to commitments; the School simply paid more than it originally planned. For example, the original commitment may have been to pay a portion of a faculty's salary for a year, but because the department couldn't find a permanent source of funding, the School of Medicine made payments for an additional year.

School of Medicine officials told us additional payments often are necessary because the original commitment may be made several years earlier, and market conditions may create a need to reassess the amount of funding required. For instance, an original

commitment may have been made to help fund a faculty salary for $70,000, but because of nationwide shortages, it may be necessary to increase that salary amount to $85,000 in order to attract a quality professor.

The Medical Center Has A $247 Million Five-Year Capital Plan With Identified Funding Sources

As required, the Kansas Board of Regents and Legislature have reviewed and approved the Medical Center's five-year capital plan.

Projects in the Medical Center's capital plan include deferred maintenance, new facilities, and renovations. The plan provides a five-year timeline of anticipated building needs starting in fiscal year 2009. The plan also includes an estimated project cost and funding sources. Deferred maintenance is included in the plan for the first time.

Figure 1-6 provides descriptions, funding sources, and estimated costs of all six projects outlined in the Medical Center's capital plan.

Figure 1-6
Medical Center's Five-Year Capital Budget Plan

Project Title	Description	Sources of Funding	Estimated Cost
Kansas Masonic Cancer Research Facility	Construct the 225,000 square foot phase one of the Cancer Research Facility	Federal Grants Private Gifts Kansas Economic Growth Authority Proposal	$96,775,000
Deferred Maintenance	Replacement of roofs, windows, transformers, fire alarms, chillers, and HVAC at various buildings	State General Fund University Interest Infrastructure Maintenance Fund	$72,000,000
Ambulatory Care Facility	Construct 207,800 square foot facility to house outpatient clinics, clinical teaching areas, and staff offices	Revenue Bonds	$66,000,000
Parking Facility #4	Construct a 580 vehicle capacity parking facility	Revenue Bonds	$8,550,000
Lied Biomedical Research Building Renovation	Renovate and modernize existing laboratories	Federal Monies Private Gifts	$2,100,000
Parking Lot/ Garage Maintenance	Maintain existing lots and construct new parking lots	Parking Funds	$1,400,000
Total			**$246,825,000**

Source: Division of the Budget records

Funding sources already have been identified for all the capital projects. Funding will come from a variety of sources. Monies designated for maintenance or capital projects can't be used for operating expenses. Funding sources for the $246.8 million in identified projects include the following:

- $86.8 million (35%) Kansas Economic Growth Authority (a component of the Bioscience Authority)
- $74.5 million (30%) Revenue Bonds

- $59.9 million (24%) State General Fund
- $9.8 million (4%) Infrastructure Maintenance Fund
- $6.1 million (3%) Private Gifts
- $6.0 million (2%) Federal
- $2.3 million (1%) University Interest
- $1.4 million (1%) Parking Funds

Officials Recently Unveiled Plans To Spend $800 Million Over 10 Years To Expand Research

The plan was unveiled in June 2007 by the Medical Center's Executive Vice Chancellor. The plan shows the Medical Center's strategic vision for expanding research.

The plan calls for new faculty and additional square footage. ***Figure 1-7*** on the next page shows that, as envisioned, the plan would add 244 faculty members at a cost of about $454 million, and 862,500 square feet of additional space at an estimated cost of $345 million. Some faculty and square footage would be shared between programs.

As the figure shows, the Cancer Center is a significant portion of the plan. Of the 310,000 additional square footage listed for the Cancer Program, 225,000 square feet is included in the Medical Center's five-year capital plan, which has dedicated funding sources. As shown in ***Figure 1-6***, the five-year capital plan estimated it would cost nearly $96.8 million to construct the 225,000 square foot Kansas Masonic Cancer Research Facility. Officials told us that, as funding sources are identified for <u>other</u> projects outlined in ***Figure 1-7,*** they'll be added to the capital plan.

Medical Center officials hope to fund this vision partially through an affiliation with St. Luke's Hospital. Officials told us an affiliation with St. Luke's Hospital may generate some additional funding for this vision in the following ways:

- St. Luke's Hospital may provide funding as part of an affiliation agreement. This amount has not yet been determined.

- Kansas City foundations and businesses may generate $175 million in funding if an affiliation with St. Luke's Hospital and Children's Mercy Hospital becomes a reality. The Hall Foundation would give $50 million, and an additional $125 million would come from the Kansas City community.

Officials currently are trying to find other sources of funding, as well. They told us that as much as $332 million may be generated by grant funding, but that more funds still are needed. Other possible sources Medical Center officials mentioned include:

- **State Appropriations**. The Medical Center has requested and received $5 million in State funding for fiscal years 2007 and 2008 for

Figure 1-7
Additional Faculty and Space Outlined in the 10 Year $800 Million Plan

Program Name	New Senior Faculty	New Junior Faculty	Additional Square Footage
Established Programs			
Cancer	60	25	310,000 (a)
Neuroscience/Brain Health	14	10	30,000
Maternal/Fetal/Child Health	9	5	200,000
Reproductive Sciences/Fertility	3	0	
Kidney	3	6	10,000
Liver	4	5	14,000
Emerging Programs			
Bioengineering	10	9	180,000
Bone	2	0	10,000
Diabetes	10	10	30,000
Heart	2	1	TBD
Immunology/Virology	3	5	6,000
Integrative Medicine	4	4	12,500
Obesity	10	4	14,000
Ophthalmology	10	TBD	TBD
Personalized Medicine	1	2	3,000
Public Health	2	1	25,000
Translational Research Program			
Heartland Institute for Clinical and Translational Research	15 (b)	18 (b)	18,000
Drug Discovery	3 (b)	10 (b)	78,000 (b)
Shared Resources			
Bioinformatics	2	0	0
Biostatistics	3	5	0
Compound Synthesis	0	0	0
High Throughput Screening	1 (b)	2 (b)	0
Mass Spectrometry/Prometrics	0	0	0
Total	**152**	**92**	**862,500**
Estimated Cost	**$453.6 Million**		**$345.0 Million**

Source: The University of Kansas Medical Center "Time is Now" plan

(a) Of the 310,000 square feet listed, 225,000 square feet also is included in the 5-year capital budget.

(b) Already included in other programs listed.

the Cancer Center. Officials told us they plan to continue requesting $5 million a year over the next 10 years for a total of $50 million.

- **Johnson County Research Triangle Tax**. If voters approve this tax, it could generate $5 million to $6 million per year for as many years as voters approve.

- **Bioscience Authority**. The Medical Center could apply for funding to be used for renovating facilities and infrastructure, and attracting eminent scholars.

- **Kansas University Hospital**. The Medical Center is negotiating a new affiliation agreement with the Hospital that may provide more support than in the past.

- **Federal Moneys**. These funds would be in addition to research grants outlined in the vision, and may come from non-research grants or other earmarks.

- **Other Sources**. Contributions from foundations, private donors, or other sources.

Medical Center officials told us it may take longer than 10 years to find funding sources for all items in the vision, and they would follow through only with items they find funding for.

CONCLUSION: It didn't appear to us that the Medical Center was negotiating with St. Lukes Hospital to help cover existing financial obligations. However, it is clear the Medical Center would use funds from such an agreement to help carry out its future vision for adding faculty and staff.

RECOMMENDATION:

1. To ensure the Legislature has the most up-to-date financial information, Medical Center officials should report the following information from its 2007 consolidated financial statements to the Legislative Post Audit Committee before the 2008 session:

   a. Current assets for ongoing operations
   b. Current liabilities for ongoing operations
   c. Net current assets for ongoing operations
   d. Current ratio for ongoing operations, and
   e. Ending cash balances

   In completing this information, Medical Center officials should work with Legislative Post Audit staff to ensure that the methodology for the above calculations is consistent with the ones used in this report.

Question 2: How Has the Money the Legislature Appropriated for the Medical Center's Cancer Center Been Spent?

ANSWER IN BRIEF:	*The KU Cancer Center was formed to coordinate cancer research and care among various entities in Kansas and western Missouri. The Center is working toward designation from the National Institutes of Health as a Cancer Center and Comprehensive Cancer Center. The Legislature appropriated $5 million to the KU Cancer Center for both fiscal years 2007 and 2008 to help it reach Cancer Center designation. In 2006, Center officials indicated that funding would be used for research, drug discovery, outreach, and administration. In fiscal year 2007, about $2.2 million of the $5 million appropriation (45%) was used for research. More than $4 million of the appropriation was used for salaries, primarily for researchers and professors. For fiscal year 2008, the Center currently projects it will spend about 16% of its $5 million appropriation on research. Center officials indicated these funds are used to fill the gaps that other funding sources don't cover. These and other findings are discussed below.*

The KU Cancer Center Is an Umbrella Organization Formed To Coordinate Cancer Research and Care In Kansas and Western Missouri

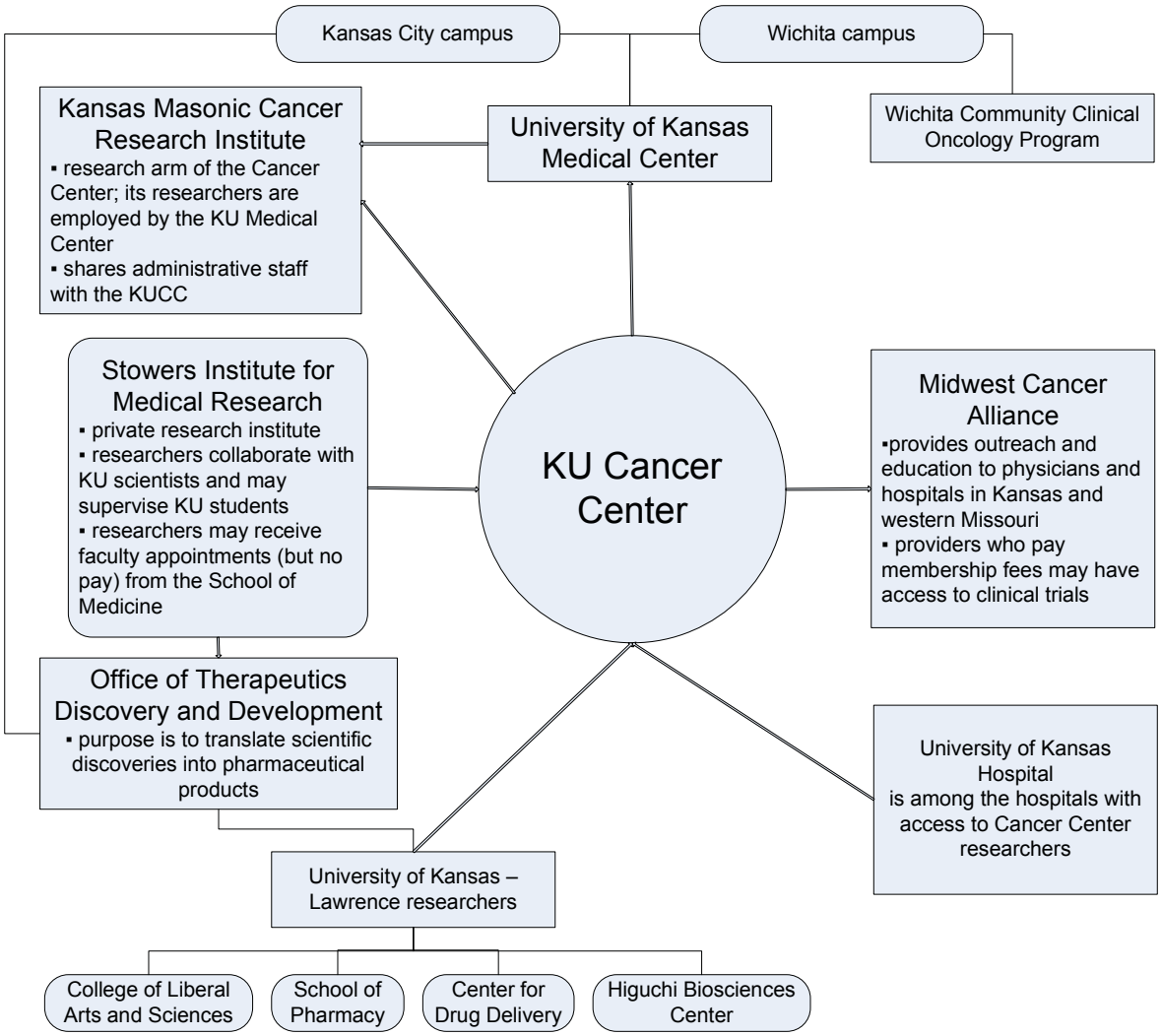
The KU Cancer Center, so named in 2005, developed from the University of Kansas' Kansas Cancer Institute, which started in 1996. Its goal is to "end cancer" through prevention, research, improved diagnosis, and enhanced treatment in Kansas and western Missouri. The Cancer Center was created to help coordinate the work of multiple entities in cancer research.

As ***Figure 2-1*** on the next page shows, those entities are both inside and outside the University of Kansas, and include the privately funded Stowers Institute for Medical Research in Kansas City, Missouri.

The Cancer Center's budget from all sources was about $9.8 million in fiscal year 2007, and is projected to be about $11.5 million for fiscal year 2008. In all, $5 million of the total for each year came from an appropriation by the Legislature.

The KU Cancer Center is working toward designation from the National Institutes of Health as a Cancer Center and then as a Comprehensive Cancer Center. There are 23 Cancer Centers and 39 Comprehensive Cancer Centers around the country, including centers in St. Louis, Omaha, Iowa City, and Aurora, Colorado. According to officials at the KU Cancer Center, the benefits of Cancer Center and Comprehensive Cancer Center status include the following:

Figure 2-1
Major Participants in the KU Cancer Center



Source: KU Cancer Center

- a grant of up to $1 million annually
- increasing the KU Cancer Center's ability to recruit and retain top researchers, who can increase research funding from additional sources
- easier patient access to advanced cancer care and therapies
- easier physician access to clinical trial information and the services of consultants

To reach these designations, Cancer Center officials said they must recruit scientists, renovate and construct research facilities, build basic science and clinical oncology research programs into "nationally recognized centers of excellence," enhance collaborative research, and deliver newly developed diagnosis tools, therapies, and prevention strategies to people across the

region. These actions are expected to cost between $83 million and $142 million a year through 2016, for all entities involved.

The KU Cancer Center had expected to apply for Cancer Center designation in 2009, but National Institutes of Health officials recently have advised the Center to apply in 2010 instead because of federal budget constraints. The Cancer Center is working to achieve Comprehensive Cancer Center designation in 2016. A Cancer Center focuses on basic, population, or clinical research; a Comprehensive Cancer Center must have all three types of research plus community outreach, education, and training activities.

The Legislature Appropriated $5 Million To the Cancer Center for Both Fiscal Years 2007 and 2008

In 2006, KU Medical Center officials requested $5 million in annual funding to help the KU Cancer Center achieve the national Cancer Center designation. At the time, officials indicated the funding would be used for research, drug discovery, trials and outreach, and administration. These categories of expenditures are summarized in ***Figure 2-2.***

Figure 2-2
KU Cancer Center Spending Categories

Category	What the category includes
Research	Support for faculty salaries and for research equipment and supplies. This category includes • pilot projects prior to grant funding • start-up funds for newly recruited researchers • post doctoral researchers • "big-ticket" research equipment • the Center's Scientific Advisory Board
Office of Therapeutics Discovery and Development ("drug discovery")	Support for efforts to translate discoveries into potential drug products.
Clinical Trials Office, Midwest Cancer Alliance, & Outreach Programs ("trials and outreach")	Support for the following efforts: • expansion of clinical trials of new drugs and therapies • establishment of a regional alliance of oncologists and other cancer care professionals • delivering screening, prevention, and cancer education programs throughout the State
Infrastructure Support ("administration")	Administrative expenses, such as salaries for the director, top managers, and central administrative staff, plus office expenses.

Source: KU Cancer Center October 2006 publication, "FAQ: $5 Million Annual State of Kansas Appropriation"

The Legislature appropriated $5 million to the Cancer Center in fiscal year 2007 and again in fiscal year 2008 (the KU Medical Center had included the $5 million amount in its fiscal year 2008 budget request). The appropriations acts didn't specify how the moneys were to be used.

In Fiscal Year 2007, The Cancer Center Spent 45% of Its Appropriation On Research; Most Funding Went To Pay Salaries

As the middle set of columns in ***Figure 2-3*** shows, in fiscal year 2007 the Cancer Center spent about $2.2 million of the $5 million appropriation (45%) on research. Its actual spending in each category was very close to what Center officials had told legislators in 2006.

Figure 2-3
Projected and Actual Spending of the $5 Million Appropriation for Fiscal Years 2007 and 2008

Category	Spending Proposed (a)		Actual FY07 Spending		Projected FY 08 Spending	
	%	Amount	%	Amount	%	Amount
Research	44%	$2,200,000	45%	$2,229,000	16%	$788,000
Infrastructure Support (Administration)	28%	$1,400,000	27%	$1,368,000	36%	$1,790,000
Clinical Trials Office, Midwest Cancer Alliance & Outreach Programs	20%	$1,000,000	22%	$1,084,000	36%	$1,817,000
Office of Therapeutics Discovery and Development	8%	$400,000	6%	$319,000	12%	$605,000

(a) The percentages listed were given in the KU Cancer Center's booklet, "FAQ: $5 Million Annual State of Kansas Appropriation."
Sources: KU Cancer Center, LPA analysis of KU Cancer Center expenditures

More than $4 million of the $5 million appropriation for fiscal year 2007 was spent on salaries. Using job titles as guides, we determined that most of the money spent on salaries and wages in fiscal year 2007 was for researchers and professors, as follows:

- researchers or professors: (basic and clinical) $2,645,000 (66%)
- administration staff $1,159,000 (29%)
- information technology staff: $ 194,000 (4%)
- student employees: $ 31,000 (1%)

TOTAL SALARIES & WAGES $4,029,000

The remaining $971,000 (19%), was used for operating expenses in the following categories:

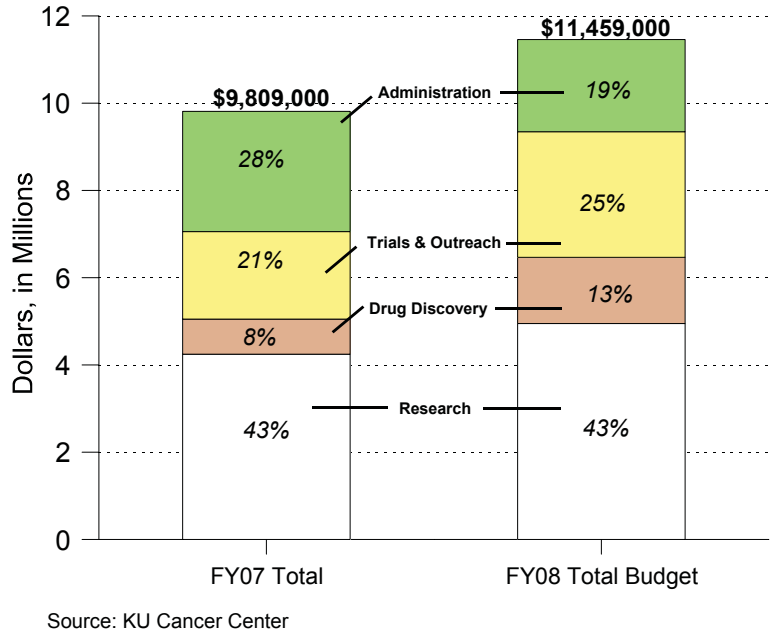
- equipment and furniture: $289,000
- fees for data and software: $144,500
- research supplies: $100,000
- computers: $ 69,500
- other: (includes copier rental, chairs, office supplies, travel, telephones) $368,000

TOTAL OTHER EXPENDITURES $971,000

For Fiscal Year 2008, The Cancer Center Projects It Will Spend 16% of Its $5 Million Appropriation on Research

The last set of columns in ***Figure 2-3*** show that, as of July 2007, the Cancer Center's fiscal year 2008 budget projects it will spend $788,000 of the $5 million appropriation (16%) on research, a much smaller figure than in fiscal year 2007. Center officials told us the amount actually spent in the various categories during fiscal year 2008 could change markedly, depending on what other resources become available to the Center that year.

Figure 2-4
Overall FY07 Spending and FY08 Budget



Source: KU Cancer Center

Officials also told us they weren't trying to keep spending proportions in the categories originally presented to the Legislature in 2006. The $5 million appropriation makes up about 43% of the Center's total funding for fiscal year 2008. Officials indicated the Center's private donors often specified that their donations must be used for research, so the Cancer Center uses the State appropriation to fill the gaps that other funding sources don't cover.

As ***Figure 2-4*** shows, overall about 43% of the Cancer Center's total budget from all sources for both fiscal year 2007 and fiscal year 2008 was spent on research.

CONCLUSION:

The $5 million State appropriation is a major funding source for the KU Cancer Center, but not the only source. As the Cancer Center grows and becomes more established, the uses for the State appropriation will likely change. Because the Legislature put no restrictions on how the money can be spent, it's currently being used to fill gaps that other funding sources, which may have restrictions, don't cover.

Question 3: Was the Hospital's Separation Agreement with the Former CEO Appropriate and Allowable?

ANSWER IN BRIEF:	*The Hospital Authority executed a $1.8 million separation agreement with the former Chief Executive Officer. Nothing in the law or regulation prohibited the Hospital from giving the former CEO a separation package equal to three years of her annual base salary. Because her employment agreement is confidential, we can't comment on what was in that agreement, or how it compared with the separation package. Board members told us they thought the separation package was in the Hospital's best interest. We tried to determine if similar packages had been granted in other states where the hospital CEO had left, but were unable to make a determination because information of this nature was limited. These and other findings are described in the sections that follow.*

The Hospital Authority Executed a $1.8 Million Separation Agreement With the Former Chief Executive Officer

Irene Cumming became the Chief Executive Officer when the Hospital Authority was first created in 1998. The Board has commended her on her significant efforts on behalf of the Hospital over the years, which they said led it to new levels of patient satisfaction, financial performance, care for the indigent, capital investment, and services to Kansans.

Ms. Cumming recently had been involved in negotiations with the University of Kansas Medical Center regarding the affiliation agreement between the institutions, and had spoken out in strong opposition to an affiliation agreement the Medical Center was seeking with St. Luke's Hospital in Kansas City, Missouri.

The Chairman of the Board announced at the Board's meeting on March 19, 2007, that he'd received a letter of resignation from Ms. Cumming effective June 30. The Executive Compensation Committee had met earlier in the day in connection with her resignation. According to Board members, after considering the terms of her employment agreement and her basis for resigning, the Board decided a settlement agreement was in the Hospital's best interest.

The Board Chairman told us that, in exchange for significant concessions from Ms. Cumming, and to eliminate possible litigation from the reason alleged in her resignation letter, the Board made a business decision to compensate her. The Chairman said the agreement was <u>not</u> a reward for the achievements of the CEO and the Hospital during her tenure. Ms. Cumming resigned from her position and had indicated that a change of control

had occurred. Change of control is defined in her confidential employment agreement, but basically means that the Authority had terminated her employment without cause, which would entitle her to a severance package.

At the March 19th meeting, the Board adopted a resolution giving the Chairman the authority to negotiate an agreement based on resolutions and on the general concepts discussed at the meeting. Because Ms. Cumming agreed to execute a voluntary resignation, and didn't allege that the Authority terminated her, the agreement was technically a separation agreement, not a severance agreement. It was a new agreement that superseded the employment agreement.

The final separation agreement, which both parties agreed to make public, included all the conditions the Board agreed to at its meeting, and placed a few additional responsibilities on Ms. Cumming. In developing the agreement, the Board didn't attempt to review separation agreements other hospitals entered into.

Under the separation agreement, the Hospital agreed to pay the former CEO $1.8 million upon her departure. This amount, which was paid out in a lump sum payment on July 2, 2007, equaled three years at her then-current annual salary. In exchange for this compensation, the separation agreement also spelled out the ongoing responsibilities she agreed to perform, and the various concessions she agreed to make. Those were as follows:

- fully and completely release the Hospital from any and all claims arising from her employment, employment agreement, and the termination of her employment
- execute a voluntary resignation upon the request of the Board
- not compete in the nine surrounding counties of the Kansas City region for two years
- not solicit, contract with, or retain the services of any current or former employee of the Hospital who'd worked for the Hospital since January 1, 2007, for one year from her date of termination
- not use or disclose confidential information for four years
- consult on matters she has knowledge of for one year
- cooperate in claims or lawsuits involving the Hospital where she had knowledge of the facts for three years, and after this time at a mutually agreeable rate of compensation
- mutually agree not to make disparaging remarks about the other party

Nothing Prohibited the Hospital Board From Spending this Amount For the Former CEO's Separation Package

As described in the Overview, the University of Kansas Hospital Authority was created in 1998 when the Legislature split the Hospital from the University of Kansas Medical Center. The legislation made the Hospital an independent public authority governed by a 19-member Board of Directors appointed by the Governor.

Although the Hospital retained the University of Kansas name, it's no longer part of the University or the Medical Center. The 1998 legislation stated the Hospital was an independent instrumentality of the State, its employees weren't employees of the State, and it wasn't subject to State spending or purchasing laws. In addition, the Hospital doesn't receive any State funding.

Our review showed that nothing in State law or regulation prohibited the Hospital's Board of Directors from authorizing a separation package for the Hospital's former CEO. In fact, the enabling legislation specifically allows the Board to provide for the compensation allowances, benefits, and expenses of the CEO.

The Hospital's by-laws don't address the departure of a CEO, and it has no policies or procedures dealing with separation packages. The Hospital's attorney told us it would be unusual for a hospital to have policies in these areas because each situation is unique; the terms of a settlement agreement would vary depending of what the employer needed from the departing employee.

Although there was little hard information we could review or report on, we concluded the separation agreement did not appear to be out of line, assuming Ms. Cumming carries out the additional responsibilities outlined in the agreement. Our conclusions were based on a number of factors, including our review of Ms. Cumming's employment agreement and letter of resignation, the limited information we could obtain from other teaching hospitals, and our understanding of what it meant to make the Hospital a separate authority so it could compete in the private marketplace. Each area is described below:

- Our conclusions are based in part on the information in Ms. Cumming's employment contract and letter of resignation, but we are prohibited by law from reporting on what's in her employment contract. The Hospital is subject to the Kansas Open Records Act, but the Board has asserted that this document is confidential, citing a statute in the Hospital Authority Act that allows the Board to make confidential any information that involves proprietary issues, the disclosure of which may be harmful to the Hospital's competitive position.

- We tried to contact seven teaching hospitals affiliated with public medical schools whose CEOs had left since 2003 to try to obtain information about any severance or separation packages they may have provided. Only five responded, and one of those wouldn't provide any information about the CEO who left.

  Officials at three hospitals indicated they'd given no severance or separation packages for two CEOs who retired, and one who left of his own accord. Officials at the fourth hospital reported that the CEO had left by mutual agreement with the hospital's board. That CEO was granted a severance package for one year of salary continuation, plus other benefits.

- Making the Hospital a separate authority run by an independent board of directors essentially gave the Board the authority to follow a private-sector model in operating the Hospital and competing with other hospitals in the Kansas City area. Giving the Board that authority also gave it the freedom to decide what actions it deemed to be in the best interests of the Hospital.

- That's apparently what it did in hiring and compensating Ms. Cumming as CEO, who has been credited with turning the Hospital's financial situation around, and in deciding to pay her a separation agreement to avoid potential litigation costs, obtain her services in the future, and prohibit her from taking certain actions. Those justifications did not appear to be unreasonable. We can't say whether the $1.8 million separation payment was the right amount, but no State funds were used in making that payment, and the Board was acting within its legal authority.

CONCLUSION:	The Hospital isn't bound by State purchasing laws and doesn't have specific by-laws relating to major expenditures. It is an independent instrumentality of the State with an oversight Board made up of University officials, Hospital officials and members of the public. Authority Board members were involved and approved the granting of this separation agreement, which involved concessions from both sides. Board members felt this decision was in the best interests of the Hospital, and we didn't see anything that would say otherwise.

Question 4: Was the Hospital's Purchase of an Electronic Medical Records System Appropriate and Allowable?

ANSWER IN BRIEF:	*In April 2006, the Hospital contracted for a new medical records system projected to cost about $50 million over five years. Epic was more costly than Cerner, but the difference was much smaller than the $30 million some thought. Epic was more expensive no matter how you look at costs, but the five-year cost difference was calculated at between about $1 million and about $12 million. The range of costs resulted from uncertainty about the amount of work the Hospital would have to supply to implement Cerner's software. The Hospital's consultant thought it would take significantly more time than Cerner projected. The Board's decision appeared to be based on the fact that Epic did the best in all the Hospital's evaluations, and that physicians and staff preferred it to Cerner. Board members told us cost was a secondary consideration. These and other findings are described in the sections that follow.*

The Hospital Contracted For a Medical Records System Projected To Cost About $50 Million Over Five Years

In Fall 2004, Hospital officials decided they needed to start planning for improving its medical records automation.

The Hospital hired a consultant to help it conduct a needs assessment, then contracted with the same consultant to help find a vendor. The consultant (FCG) and Hospital staff spent four months talking to key groups from the Hospital, the Medical Center, and Kansas University Physicians, Inc. (KUPI). Those groups included physicians, nurses, department chairs, ancillary department managers, and others. This process identified the Hospital's needs: officials wanted an advanced clinical information system that would integrate and automate all aspects of patient contact—from scheduling to diagnosis—and put complete information about each patient at a clinician's finger tips. Such software was expected to enhance quality and patient safety.

In June 2005, the Hospital sent a request for quotation to four vendors that appeared to have software best suited to the Hospital's needs. To help it analyze all the costs the Hospital itself would incur over the first five years of owning the software, Hospital officials also asked vendors for detailed estimates of other costs they could expect to incur in implementing and maintaining the software, such as additional hardware, data conversion, Hospital staff time, and training.

Three vendors responded and their proposals were evaluated—Cerner Corporation (a local firm from Kansas City, Missouri), Eclipsys, and Epic Systems Corporation.

After an extensive process to evaluate the software, the Board chose to purchase a system from Epic with a five-year total cost of approximately $50 million. This price includes the total cost of the system during that period, including hardware, software, and Hospital staff members' participation in the implementation. After the Board purchased the system, legislators expressed concerns that the Hospital could have purchased a system from Cerner, the local vendor, for $30 million less. In investigating this concern, we looked closely at the Hospital's costs analyses and the process it used to evaluate vendors.

As allowed by law, the Hospital declared most of the data we reviewed and collected in working on this question as confidential because of its proprietary nature. As such, we are reporting our findings in general terms to avoid divulging confidential information.

Epic Was More Costly Than Cerner, But the Difference Was Much Smaller Than the $30 Million Some Thought

Comparing vendors' bids was not straightforward for this complex a project. Software costs were a relatively small part of the total project costs. The project also included hardware costs for servers, storage, and end-user devices such as tablets.

In addition, the Hospital expected to incur significant staff costs over time for re-engineering its own business processes to work more efficiently with the software, testing the intermediate and final products, and training users. As a result, the most meaningful comparison of costs for such a project looks at the total five-year costs of ownership.

In reviewing the three bids submitted for this project, we noted that the vendors didn't always provide all the information requested, didn't always use the consistent formats provided, or didn't always provide the same types of information. Generally, the major differences were in the areas of estimates of implementation costs.

Cerner's final bid was most different, because it lumped all its software costs in with server hardware (which the Hospital was intending to buy separately), server maintenance, vendor travel, and some vendor implementation costs. This complicated comparisons between vendors because the other bids may have categorized vendor implementation costs in different ways.

FCG analyzed the costs for the Hospital, including an in-depth analysis of the time it thought the Hospital's staff would need to spend implementing the project (and the resulting implementation costs). The Board relied on FCG's analyses when it discussed choosing a vendor.

The consultant's analyses showed that the total five-year cost of ownership for Epic and Cerner varied between about $1 million and $12 million, depending on which costs were included. Based on its analyses, FCG had estimated it would take about 365,000 Hospital staff hours over the five-year period for this type of project, regardless of vendor. Epic's bid also assumed that Hospital staff would have to spend a significant amount of time implementing the project. Cerner's bid, on the other hand, estimated the Hospital could implement its software package for far fewer hours than FCG's estimates.

FCG and Hospital staff told us that, because of the re-engineering, testing, and training costs involved, they didn't think the project could be done with so few hours of Hospital staff's time.

For its presentation to the Board, FCG officials calculated two implementation cost estimates for Cerner:

- one based on the number of hours FCG thought it would take Hospital staff to implement the project (applied uniformly to all vendors). That estimate showed that the five-year cost of ownership for Epic's proposal was about $1 million more expensive than Cerner's bid.
- one based on the number of hours Cerner thought Hospital staff would have to spend on implementing the project (applied to Cerner). The other two vendors had the FCG estimate of implementation costs applied to them. Under this scenario, FCG calculated that Epic's bid was about $12 million more expensive than Cerner's bid.

Under either scenario, the total five-year cost of ownership in the Cerner bid was not $30 million less than the total cost of ownership in the Epic bid.

The Hospital has just completed the first phase of implementing the Epic software, and officials told us the hours staff have spent so far are running very close to the hours FCG estimated.

The Hospital Board's Decision Appeared To Be Largely Based on Which Software the Doctors and Staff Preferred

The decision of which vendor to hire was the Board's responsibility. The Board wasn't involved directly in the evaluation process, but depended heavily on the results of that process in making its decision. FCG and Hospital officials presented the results to the Board's Finance and Investment Committee on April 10, 2006, and to the full Board the following day. Because of the importance of the evaluations, we reviewed the evaluation process Hospital staff used to see if it was reasonable.

The Hospital's evaluation process was very thorough and appeared to be objective. The documentation showed that

Hospital officials put a lot of resources into evaluating the vendors and the software, and involved different types of users in all aspects of the process—including physicians, nurses, ancillary clinical staff, and technical staff.

FCG helped the Hospital organize its evaluation process, and also provided the Hospital with tools to help make the various evaluations more objective and effective. Below is a list of the activities the Hospital carried out:

- Scored and rated vendor proposals
- Evaluated vendor demonstrations (Each vendor conducted 17 different demonstrations. All employees were invited to participate in evaluating the demonstrations.)
- Conducted a post-demonstration survey asking subjective questions of people who attended the demonstrations
- Called references (11 subject-matter teams called their counterparts in hospitals that used the software)
- Made site visits (10-12 member teams visited five hospitals)

In addition, Kansas University Physicians, Inc. (KUPI) conducted an independent evaluation of the three vendors focusing on out-patient modules, including doing its own reference calls and site visits.

To ensure consistency in scoring vendors, the Hospital supplied separate evaluation tools for each type of evaluation. For example, for reference calls each team had a specific list of questions to ask, and scored each vendor on each question. For the vendor demonstrations, the Hospital gave vendors different scenarios and scripts for each demonstration that they had to follow in demonstrating their software. The attendees had the same scripts and rated the vendor on each action the scripts called for.

By using set questions and scoring each question, the Hospital was able to quantify results and objectively compare vendors. Medical Center staff expressed concerns regarding the selection process, and those are detailed in the box on the next page.

The Board chose Epic after it outperformed other vendors in the evaluations. FCG and Hospital staff detailed the results of all the evaluations in their presentation to the Board. Epic came out ahead in each separate evaluation, often by a large margin. For example, in the post-demonstration survey, people who attended demonstrations for all three vendors were asked to rank them 1st, 2nd, and 3rd. About three-quarters ranked Epic 1st. Further, the independent KUPI investigation mirrored the Hospital results—Epic came out ahead by a large margin.

Medical Center Officials Voiced Several Concerns About the Hospital's Evaluation Process and Decision To Purchase the Epic System

While doing our audit work, we heard several concerns about how the Hospital had conducted the evaluation process, or about the decision to purchase Epic. Each area of concern is listed below, along with our findings.

- **Only physicians were allowed to complete the post-demonstration surveys**. This didn't appear to be true. The Hospital didn't collect names on the surveys so we couldn't match names, but more people answered the questions than the number of doctors who participated in any part of the evaluations or the needs assessment process.
- **Only those who attended all three vendors' demonstrations were allowed to complete the post-demonstration surveys**. This was true for one question on the survey; however, there were several questions on the survey. For the most part, anybody could answer the questions no matter how many demonstrations they attended. However, one question asked respondents to rate vendors #1 through #3. Hospital officials told us the survey restricted this question only to those who attended demonstrations from all three vendors. Indeed, while most questions had about 160 respondents, that particular question had only about 100 respondents.
- **Epic's software isn't very good for research purposes**. This is true; however, it doesn't appear that software from the other vendors would be better. This type of software is specifically designed for automating medical records in hospitals and clinics. We were told that research has very different software needs, and isn't supported well by any of these systems.

Most importantly, in the evaluations in which you can see results by group, the physicians preferred Epic. We talked to the Hospital's Chief Medical Information Officer who told us doctors preferred Epic's software because they found it much easier to use than the other vendors' products.

We also talked to the Chairman of the Board and to the Finance Committee Chair about the decision to purchase Epic. Both said the decision was based primarily on the results of the evaluations—which software was more functional and which one the physicians preferred. Epic was at the top in both those areas. They said that while cost obviously was important, it was a secondary consideration in this particular decision.

CONCLUSION: It's difficult for us to independently judge whether Epic was worth the extra expense the Hospital paid, or to know whether the Hospital's implementation costs would have been significantly less with Cerner's system. But it was clear that the people who were going to use it preferred Epic's system to Cerner's by a wide margin. Research on system development has shown that lack of user involvement is one of the top causes of project failure. That certainly has been the case in State government projects we've audited in the past.

APPENDIX A
Scope Statement

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on April 24, 2007. The audit was requested by Senators Hensley and Steineger, and Representatives Neufeld and Morrison.

The KU Medical Center and KU Hospital: Reviewing Selected Financial Issues

This audit involves concerns related to both the University of Kansas Medical Center and the University of Kansas Hospital. The Medical Center is under the jurisdiction of the University of Kansas. The Hospital used to be a part of the Medical Center, but in 1998, the Legislature created the University of Kansas Hospital Authority to operate the University of Kansas Hospital.

The Medical Center has been working to win certification from the National Cancer Institute as one of the country's premier cancer centers. Obtaining the designation involves developing new treatments and drugs, increasing participation in clinical trials, and attracting top rated doctors and scientists. The Medical Center is also currently pursuing an affiliation with St. Luke's Hospital in Kansas City, Missouri. The 2006 Legislature made special appropriations for $5 million for both fiscal years 2007 and 2008 for the Medical Center's Cancer Center.

Recently, legislators have expressed concerns related to financial operations of both the Medical Center and the Hospital. These include concerns that the Medical Center doesn't have sufficient cash flow to cover its obligations and that the affiliation with St. Luke's is being pursued to help the Medical Center cover current or future financial obligations. Legislators have also expressed related concerns that the Medical Center has made employment agreements with faculty and department heads that contain commitments of staffing, facilities and research projects which the Medical Center has not provided. Other concerns have been expressed about how money the State has provided for the Medical Center's Cancer Center has been spent. Legislators also are interested in knowing whether particular expenditures made by the Hospital Authority are allowable, appropriate, and in keeping with the Authority's fiduciary responsibilities in its oversight of Hospital finances.

A performance audit of these topics would address the following questions.

1. **Does the Medical Center have sufficient cash flow to cover its major financial obligations and employment agreements?** To answer this question, we would review financial statements/reports for the Medical Center and key financial ratios to determine what they show about the Medical Center's financial position. We would review contracts, bills, and other documents as needed and review or prepare cash flow statements and projections to determine whether it appears the Medical Center will have sufficient revenues coming in to cover expected expenditures. As needed, we would interview officials at the Medical Center about upcoming financial commitments and the expected sources of revenue available to fund those commitments. Further, we would review the employment agreements for a

small sample of high-profile faculty who have been hired in recent years. For that sample, we would identify any commitments their employment agreements may contain, and if information is available, the dollar value of those commitments. We would interview those faculty members to determine whether those commitments have been fulfilled, and if not what they have been told about the reasons why. For any commitments not kept, we would interview Medical Center administrators to find out their reasons for not fulfilling the agreements. We would conduct other work in this area as needed.

2. **How has the money the Legislature appropriated for the Medical Center's Cancer Center been spent?** To answer this question, we would review appropriation acts or other relevant documents such as committee minutes to determine what the intended uses of the Cancer Center appropriation were. We would determine how that money has been spent, and assess whether the uses comply with the intended uses.

3. **Has the Hospital Authority's spending for certain items been appropriate and allowable?** To answer this question, we would determine what requirements the statutes place on the University of Kansas Hospital Authority with regard to major expenditures or purchases. Also, we would determine what policies and procedures that the Authority has established for approving large expenditures or purchases. We would review the Authority's recent authorization of an estimated $1,725,000 severance package for the Hospital's chief executive officer to determine whether it was allowable under State law and the by-laws of the Hospital Authority. We would determine how the amount of the severance package was determined, and we would contact other university medical centers as needed to determine whether the granting of such a package is reasonable and a common practice. Finally, we would review the purchase of the electronic medical records system to determine whether it followed all requirements of law and Hospital purchasing procedures. We would assess whether a substantially less-expensive system was available through Cerner Corporation, and if so, we would find out why the Hospital Authority chose to purchase a system reported to cost nearly $30 million more from a Wisconsin firm.

Estimated Time to Complete: 12-16 weeks

(The actual time to complete the audit will depend on the amount and type of readily available financial information the KU Medical Center and KU Hospital have compiled already)

APPENDIX B

More Information About Commitments Without Dates

Twenty of the commitments we reviewed didn't have a commitment letter which tells the date the commitment was made to that department. The following table provides information on the amount committed to these departments, as well as payments made towards these departments as of August 2007.

Appendix B
Summary of Commitments by the School of Medicine to Departments a Formal Commitment Letter

Department	Date of Commitment	Faculty Salaries	Start Up	Administrative Salaries	Infrastructure/ OOE Support	Total Committed	Total Paid as of August 2007 (a)	Percent Paid
Center for Reproductive Services	N/A	$0	$0	$43,181	$30,000	$73,181	$73,181	100%
CONFOCAL	N/A	$0	$0	$51,235	$22,225	$73,460	$73,460	100%
Radiation/Oncology	N/A	$39,853	$0	$0	$0	$39,853	$39,853	100%
General Clinical Research Center	N/A	$0	$0	$493,409	$83,347	$576,756	$567,457	98%
Lab Animal Resources	N/A	$1,259	$0	$105,307	$130,000	$236,566	$208,033	88%
Transgenic Facility	N/A	$0	$0	$239,628	$296,741	$536,369	$444,767	83%
Male Reproductive Center	N/A	$0	$0	$28,989	$0	$28,989	$22,671	78%
Mass Spectrometry	N/A	$0	$399,288	$401,930	$710,000	$1,511,218	$1,168,622	77%
Surgery-Urology	N/A	$352,029	$58,000	$0	$174,000	$584,029	$427,915	73%
Surgery-General	N/A	$866,174	$0	$0	$15,000	$881,174	$633,070	72%
Surgery-Orthopedics	N/A	$184,985	$393,363	$63,928	$23,332	$665,608	$441,954	66%
MICROARRAY	N/A	$0	$0	$0	$295,000	$295,000	$195,387	66%
Rehabilitation Medicine	N/A	$191,192	$0	$0	$36,000	$227,192	$116,393	51%
Preventative Medicine	N/A	$91,738	$0	$0	$190,000	$281,738	$91,738	33%
Building Interdisciplinary Research Careers in Women's Health	N/A	$0	$0	$0	$250,000	$250,000	$75,376	30%
Diabetes Institute	N/A	$0	$0	$88,524	$47,000	$135,524	$841	1%
Development Disabilities Center	N/A	$0	$0	$65,340	$0	$65,340	$0	0%
Electron Microscope	N/A	$0	$0	$0	$150,000	$150,000	$0	0%
HICTR-CTSA	N/A	$0	$0	$119,955	$23,100	$143,055	$0	0%
Liver	N/A	$0	$0	$0	$50,000	$50,000	$0	0%
Total	**N/A**	**$1,727,230**	**$850,651**	**$1,701,426**	**$2,525,745**	**$6,805,052**	**$4,580,718**	**67%**

Source: School of Medicine commitment data
(a) Payments may be understated because payment data wasn't available before fiscal year 2003.

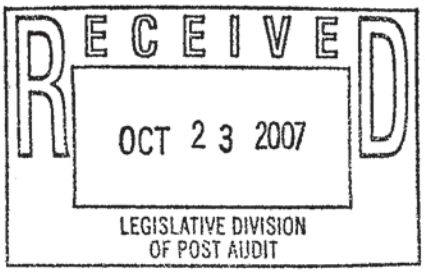
APPENDIX C

Agency Response

On October 15, 2007, we provided copies of the draft audit report to the University of Kansas Medical Center, University of Kansas Hospital and the Kansas Board of Regents.

The Medical Center and Hospital generally concurred with the report's findings, conclusions, and recommendations. Responses from each are included as this appendix. We didn't receive a response from the Board of Regents.

KU THE UNIVERSITY OF KANSAS
Medical Center



October 22, 2007

Barbara J. Hinton
Legislative Post Auditor
Legislative Division of Post Audit
800 Southwest Jackson Street, Suite 1200
Topeka, KS 66612-2212

Dear Ms. Hinton:

Enclosed are the University of Kansas Medical Center's (KUMC) responses to the Legislative Post Audits draft reports on the performance audits; KU Medical Center and KU Hospital: Reviewing Selected Operational Issues and KU Medical Center and KU Hospital: Reviewing Selected Financial Issues.

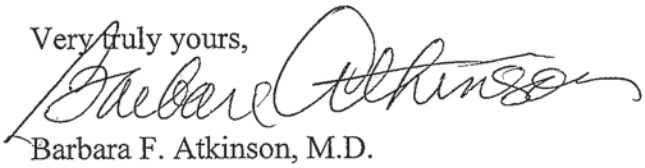
The University of Kansas Medical Center enjoyed the opportunity to work with the staff of the Legislative Division of Post Audit during their study of the issues presented. Their professionalism and skill were evident throughout their interactions with our team. We want to commend Barbara J. Hinton and her team for accomplishing a great deal of work in a very short period of time. We strongly believe that as a result of their work, policy makers and the public will be better informed about the mission of their academic medical center. We appreciate the auditors' insights and their perspective. The information they have set forth in this report illuminates a number of complex questions and provides a valuable resource.

Because of the complexity of some of the issues involved we provide in our response additional context with which to evaluate the findings and data set forth in this audit.

We hope that legislators and others who look to this audit will take advantage of our open invitation to discuss any aspect of this audit with us. We look forward to a dialogue with legislators on how best to continue and build on the unprecedented momentum the University of Kansas Medical Center and Hospital have enjoyed over the last five years. Our success would not be possible without the support and leadership of many Kansans who believe in our mission of service, research, education and clinical care. We take seriously our role as a source of hope and healing for many Kansans.

If we can be of further assistance to the staff of the Legislative Division of Post Audit, the members of the Post Audit Committee or other members of the Kansas Legislature we hope you will not hesitate to call on us.

Very truly yours,



Barbara F. Atkinson, M.D.
Executive Vice Chancellor
Executive Dean, School of Medicine

BFA:dab

Enclosures

UNIVERSITY OF KANSAS MEDICAL CENTER (KUMC) RESPONSE TO LEGISLATIVE POST AUDIT REPORT; KU Medical Center and KU Hospital: Reviewing Selected Financial Issues.

Question 1: Does the Medical Center have sufficient cash flow to cover its major financial obligations and employment agreements?

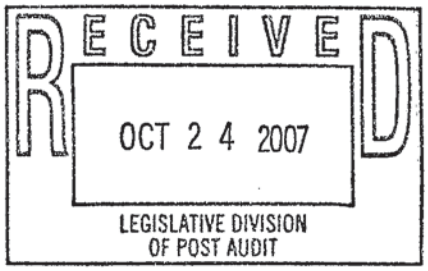
Response: KUMC concurs with the Legislative Post Audit "Answer in Brief" and "Conclusion." The additional information requested in the "Recommendation" section will be provided within 45 days at the completion of KUMC's FY 2007 consolidated financial statement.

Question 2: How has the money the Legislature appropriated for the Medical Center's Cancer Center been spent?

Response: KUMC concurs with the Legislative Post Audit "Answer in Brief" and "Conclusion."

Bob Page
President & Chief Executive Officer
Hospital Executive Office

THE UNIVERSITY OF KANSAS HOSPITAL
KUMED



October 22, 2007

Ms. Barbara J. Hinton
Legislative Post Auditor
Legislative Division of Post Audit
800 SW Jackson Street, Suite 1200
Topeka, KS 66612-2212

Dear Ms. Hinton:

The following is the response of The University of Kansas Hospital to the Legislative Division of Post Audit (LPA) regarding its completed performance audit, *KU Medical Center and KU Hospital: Reviewing Selected Financial Issues*.

LPA chose to divide Question 3, which related to whether the Hospital Authority's spending for certain items has been appropriate and allowable, into two parts for the purpose of its report. We will follow that form and address each part of the question separately.

Was the Hospital's Separation Agreement with the former CEO Appropriate and Allowable?

KU Hospital concurs with the LPA conclusion in its report on Question 3. LPA states that (1) "Nothing in the law or regulation prohibited the Hospital from giving the former CEO a separation package"; (2) "The separation agreement did not appear to be out of line"; and (3) "Board members felt this decision was in the best interests of the Hospital, and we didn't see anything that would say otherwise." The separation agreement was appropriate because the Board entered into the agreement to avoid potential litigation. The enabling legislation specifically allows the Board to provide for the compensation, allowances, benefits, and expenses of the CEO.

As LPA notes, it can be difficult to obtain information regarding separation packages. Typically those agreements are confidential. However, LPA was provided, but did not include, public information regarding a CEO separation package from the Kansas City area that we view as comparable.

Was the Hospital's Purchase of an Electronic Medical Records System Appropriate and Allowable?

KU Hospital concurs with the LPA conclusion that the Hospital's evaluation process for the selection and purchase of an electronic medical records system "...was very thorough and appeared to be objective." We also appreciate LPA's acknowledgement of the importance of the stakeholders (including physicians, nurses, and ancillary staff) in the selection of the system. We concur that user involvement is the key ingredient in the successful adoption of the system. As the report notes, lack of user involvement is one of the top causes of project failure. A well-reported example is the decision of Cedars-Sinai Medical Center in Los Angeles to shelve its new electronic medical record system in 2002 after an investment of $34 million because the system was not accepted by physician users.

Therefore, we believe that the decision to select Epic was both appropriate and allowable, as well as in the best interest of KU Hospital patients.

I would like to conclude by thanking you and your staff for the professional manner in which the audit was conducted on both of these important questions.

Sincerely,

Bob Page

Bob Page
President and Chief Executive Officer