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Imperative

Evaluate the predicted resource shortages in the health care market and plan for the anticipated impact on our system.

We instituted a new system-wide **patient satisfaction telephone survey** to help measure how our patients perceive the job we are doing and to improve areas that need improving.

Renovations and expansion at our **Discovery Care Center** helped us keep up with the demand for quality child-care in the Medical Center complex and surrounding community. The Center now can accommodate more infants and toddlers as well as on-site enrichment programs.

Thanks to a generous contribution and coordination with our **child life specialists**, our patients are now able to contact other hospitalized children by using the STARBRIGHT World computerized system that lets them share their thoughts and feelings with children in similar circumstances around the country.

The grand opening of our **online KD Store** – for employees to purchase CHKD logo merchandise at cost – was a sell-out, giving employees an inexpensive way to show their pride in working for CHKD.

We added several new **employee benefits**, including membership in Chartway Credit Union, personal short-term disability and cancer protection plans and a 529 college savings plan.

We developed proactive strategies to help us meet the challenge of the national **shortage of nurses**. We began advertising nationally, attended job fairs, held open house events and used our employment Web site.

We focused on **retaining our excellent clinical staff** by providing tenure-based award checks to bedside nurses, new salary scales for NICU, PICU and transport nurses, and incentives for internal transfers into these areas. And bonuses were established for health system employees who successfully recruit a nurse or respiratory therapist to fill a priority vacancy.

Our new **summer nurse extern program** was very successful, with 14 senior nursing students working in tandem with experienced nurses to gain clinical experiences and education that will prepare them for a nursing role in a pediatric health care setting, ideally at CHKD! And we launched an endowment effort to support future extern programs.

The clinical trials unit of our **Center for Pediatric Research** participated in 43 research projects, several in collaboration with Children's Medical Group, demonstrating a community-based research program that offers the latest care to our outpatient population.

With funding from a \$1.35 million grant from the Robert Wood Johnson Foundation, the CINCH coalition of the CPR launched a three-year regional campaign, **Allies Against Asthma**, to address childhood asthma.



Financial Review

Despite an environment that has challenged us every step of the way, CHKD ended the year with a strong bottom line and a hospital operating margin of 4.7 percent. Outpatient visits increased significantly – 3,013 more than the year before – while inpatient numbers increased just slightly. Our surgery numbers showed continued growth, rising 7.4 percent above the previous year. And visits to our emergency room rose by 3,209.

Our Children's Health Foundation had a trying year as we worked hard to manage our assets to minimize losses within a troubled financial market. Fortunately, contributions remained stable from our generous community.

In anticipation of even more fiscal challenges ahead, our organization is working to be as efficient and streamlined as possible. Our employees and managers are poised to make the changes necessary to keep us strong for those who need us most – the children.

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| CHKD Operating Statistics | | | |
|---------------------------------|--------|--------|--------|
| Fiscal Year (7/1/01 to 6/30/02) | 2000 | 2001 | 2002 |
| Number of Beds in Service | 146 | 146 | 146 |
| Patient Days | 41,581 | 42,886 | 43,522 |
| Admissions | 5,633 | 5,741 | 5,776 |
| Average Stay (days)* | 4.6 | 4.5 | 4.5 |
| Average Daily Census | 113.6 | 117.5 | 119.2 |
| Surgical Patients | 7,505 | 8,265 | 8,756 |
| Outpatient Visits | 79,247 | 84,284 | 87,297 |
| Emergency Visits | 34,519 | 37,180 | 40,389 |

*Does not include Transitional Care and Neonatal Intensive Care Units



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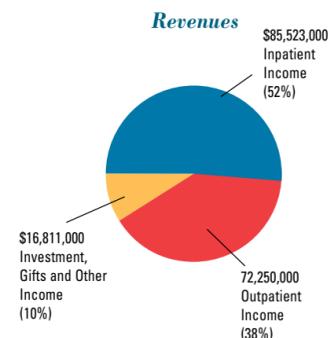
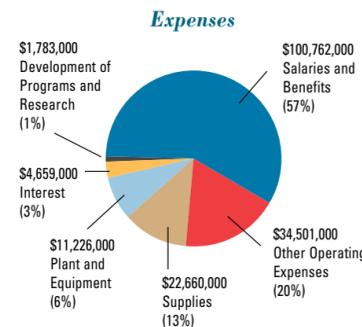


Message from the President



We take pride in our work. And we know we make a difference.

Robert I. Bonar Jr.
President/Chief Executive Officer



Those of us who work for Children's Health System have much to be grateful for as we review the challenges and accomplishments of the past year.

We are grateful because we share a mission of unquestionable value that serves the common good. We are thankful because we benefit from a level of camaraderie in our work and support from the community that few could hope to match.

We are fortunate because we love what we do. We take pride in our work. And we know we make a difference.

None of that renders us immune to the challenges facing all businesses, but it does make us better equipped to handle them. For we have one asset that others don't: uniquely inspiring employees whose optimism, creativity and determination help us to overcome these obstacles.

The challenges we face – rising costs coupled with declining reimbursements – aren't necessarily new, but they're more complex than ever before and require rapid strategic responses. For example, in the face of a national nursing shortage expected to peak in 2010, we implemented a comprehensive plan that provides cash incentives to retain and recruit nurses and other skilled professionals to our work force. This type of program is essential in our industry today, yet finding the dollars to fund it is exceedingly difficult.

Consider this: Our inpatient, outpatient and emergency department volumes were all higher this year than ever before, but a significant increase in patients does not always mean a better bottom line. CHKD devotes more than 40 percent of its care to Medicaid patients, and our Medicaid reimbursements are constant targets for state and federal reductions. On the state level, we are facing \$600,000 in Medicaid cuts over a two-year period. In 2003, our disproportionate share funding (the compensation we receive for serving such a high proportion of Medicaid patients) will also be cut unless Congress passes special "safety net" legislation aimed at protecting the ability of hospitals like ours to care for the poor.

All this comes at a time when troubled national financial markets have taken their toll on our own safety net – the assets managed by Children's Health Foundation.

Nevertheless, we march ahead and keep pace with changes and innovations that will improve our care for children. This year we made a commitment to improve virtually every aspect of patient safety and adopted this initiative as our No. 1 strategic imperative. And in another priority effort, we are well on the way to successfully meeting the April deadline for compliance with new federal privacy regulations concerning confidential health information.

In all areas, we worked harder and smarter last year. Our corporate compliance efforts focused a significant amount of work on reviewing billing claims, resulting in \$3.6 million in additional reimbursements.

Among our many proud moments last year were a couple of standouts. This summer, *U.S. News & World Report* published a cover story on CHKD surgeon Donald Nuss and his pectus excavatum surgery. The Hampton Roads publication *Inside Business* ranked us No. 2 in its listing of the region's best brands and first among health care facilities and schools.

We, in fact, have many partners in our success. Our cause is worthy of support even when our nation, communities and families faced tremendous tragedies and hardships. Last year, philanthropy provided more than \$10 million, including a record \$2,202,261 from our Telethon. Our loyal contributors to the Annual Giving Campaign helped us with nearly \$1.5 million. And our founding organization, the Norfolk City Union of The King's Daughters, continued its long-standing support with a gift of \$494,070.

These kinds of achievements – along with all those listed in our Review of Fiscal Year 2002 that follows – enabled us to finish a challenging year in strong shape. This Review helps to illustrate how our strategic imperatives focus our work and steer our organization toward greater viability and strength. It also shows how we work together as a team to give the children and families we serve our very best.

We formalized our **patient safety** practices to align with new Joint Commission requirements, appointing a safety officer and implementing an organization-wide educational program and plan that address priority areas including medication safety, patient safety education and effective error reporting.

Our nursing practice and education staff condensed **CPR training** for more than 1,000 clinical employees into just three months. This new format helped us realize a \$50,000 cost savings.

A steering group worked across clinical disciplines to develop a new analgesic order set to promote consistent and safe **pain management services**.

Our **Emergency Center** focused on changes that reduced the time that patients wait for treatment. The center ended the year with a record 40,389 patient visits, 3,209 more than the previous year.

Our **cancer program** received a three-year accreditation and initiated the Stepping Stones program for patients and families to work through the psychosocial issues of cancer and cancer treatment.

Demonstrating our adherence to exacting operational and quality standards, the **CHKD laboratory** achieved accreditation with distinction, and its blood bank earned accreditation.

Our **pharmacy** moved to a new model of operation that provides for coverage by clinical pharmacy specialists in the intensive care areas as well as participation in multidisciplinary rounds. In another safety initiative, the pharmacy began dispensing patient-specific exact-dose oral medications.

We appointed a **privacy officer** and began the system-wide education of employees and physicians on the confidentiality requirements of the federal Health Insurance Portability and Accountability Act.

We opened a seven-bed **Neonatal Step-down Unit** for the babies from our NICU who require a transitional period before being discharged home.

We responded to the extraordinary demand on our **Surgery Center** (cases increased from 8,264 in 2001 to 8,757 in 2002) by making all 10 of our ORs fully operational.

Our new **cardiac catheterization lab** was completed last winter, making it possible for us to perform more than 300 procedures, many of them sophisticated interventions that allow patients to avoid surgery.

Our **engineering department** designed and implemented a fast-response emergency shutdown switch of the hospital heating and air conditioning system in case of a biological/chemical emergency.



Imperative

Increase market share and expand revenue through the creation and broader geographic distribution of programs and services and through efficient management of resources.

Imperative

Build and strengthen physician partnerships.

The **Child Abuse Program** dedicated its new facility at 935 Redgate Avenue and served 781 children needing nearly 4,500 visits.

Our new **dermatology program** accommodated nearly 1,000 outpatients in its first six months, caring for children with acute and chronic skin disorders.

The **Care Connection for Children** was established at CHKD with a \$900,000 grant from the state to coordinate the care and support services for thousands of local children with special health care needs.

Our 13 **Children's Medical Group** practices realized increased patient visits for the year, as did our **subspecialty services**.

Our **CHKD Surgical Group** saw an increase of more than 20 percent in patient visits and OR cases. Expansion to the Peninsula and the Eastern Shore continues to help surgical patients gain convenient access to our pediatric surgeons.

Treatment volumes for **PT/OT and speech therapy services** increased 23.5 percent over the previous year. Services were expanded at our Peninsula location. Audiology services were added at the CHKD Health Center in Chesapeake.

Our **outpatient physical therapy** specialists added a service that provides an exciting new treatment tool – an interactive metronome – to help children with ADHD, sensory integration disorders, traumatic brain injury and mild autism.

Hundreds of letters and e-mails from CHKD employees, physicians and members of the Norfolk City Union of The King's Daughters helped us lobby members of Congress and the White House to support full funding of **graduate medical education**. As a result, CHKD will receive \$2.9 million this year to fund graduate medical education.

Our newest **Thrift Store** – in Kitty Hawk, N.C. – opened in July 2001 and realized record sales of \$59,111 in the first month. With a 15.8 percent increase in sales, all of our 19 **Thrift Stores** contributed a total of \$1,850,830 to CHKD – a 28 percent increase from the year before. In 2002, the Thrift Stores surpassed the \$10 million mark in cumulative contributions over 15 years.

Our **information services staff** successfully installed a new practice management system in several CHKD Medical Group practices to standardize patient scheduling, registration and physician billing. All CMG, CHKD Surgical Group and Children's Specialty Group practices and hospital clinics will receive the new system over the next year.



Imperative

Continue to evolve the system's culture to meet the highest standards in employee, physician and customer satisfaction.

The **Reach Out and Read** literacy program at several CHKD Medical Group practices continued to offer a boost to our patient care services, last year helping us put more than 4,400 books into the hands of children who come for checkups.

Our **neonatal-perinatal outreach program** was redesigned, upgraded and expanded this year to focus on communications with referring hospitals and physicians.

We moved our computerized radiography unit to the CHKD Health Center at Kempsville in order to make **diagnostic X-ray services** more convenient for referring physicians and our patients. Images taken there are electronically sent to the hospital so that interpretations by our pediatric radiologists are just as quick off-site as they are at CHKD.

In its first full year, our **weight management program** gained support from more than 100 pediatricians and family practitioners who sought a formal approach to addressing their patients' weight issues.

Some 1,000 families participated in our **community outreach** classes, lectures and related programs, many of which were held at our Medical Group practices. Many **physicians** participated in programs that ran the gamut from newborn care to discipline for teens. Our physicians also lent their expertise to dozens of newspaper, newsletter and television features.

The **CHKD Web site** underwent a major transformation with a new look and loads of new features, including a virtual tour of the hospital and more than 2,000 pages of health information – on topics from abrasions and allergies to chronic illnesses and scoliosis – complete with links to physicians who treat these conditions.

Our **physician services** representatives hosted 19 continuing medical education events and a variety of presentations during the year. Their visits to virtually every pediatrician and many family practitioners in the region helped us see significant increases in referrals from the Peninsula, Suffolk and northeastern North Carolina. Physician attendance increased by 40 percent at the 41 CME courses sponsored by our continuing **medical education department**.

The Eastern Virginia Medical School **pediatric residency program** headquartered at CHKD gained a five-year accreditation and again filled all 16 of its openings for first-year residents with outstanding medical school graduates.

We welcomed nearly 50 new physicians to our **Professional Staff** this year, and three specialists joined the **Children's Specialty Group** practicing at CHKD. The newcomers included the new chairman of the department, Hal B. Jensen, MD, who also serves as senior vice president for academic affairs for the health system.

