

# Budgeting Best Practices



**hfma**<sup>™</sup> northern california chapter  
healthcare financial management association

**Rancho Cordova,  
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## Agenda

1. Guiding Principles of Corporate Finance
2. Overview of the Integrated Planning Process
3. Financial Planning Outputs as Inputs to the Budget Process
4. Process Steps for Development of the Operating Budget
5. Using Financial Plan Targets to Monitor the Operating Budget Process
6. Incorporating New Initiatives / Capital Approvals
7. Putting It All Together
8. Using a Flexible Budget to monitor budget variances

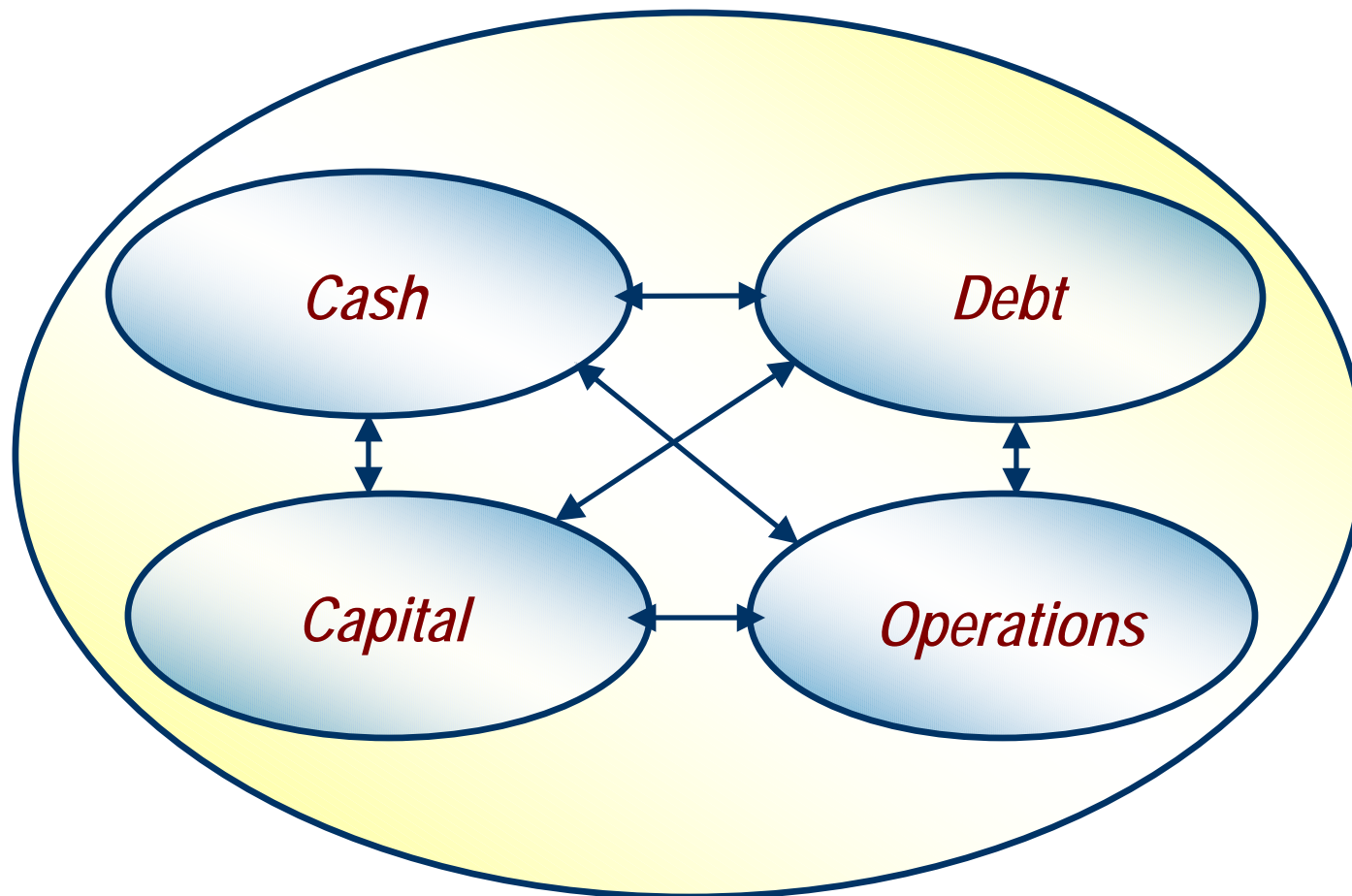
## The Seven Guiding Principles of Corporate Finance

1. Finance education – enables an organization to achieve alignment with management about the importance of an integrated planning process.
2. Calendar management – rigorous calendar management guides the integrated planning process.
3. Balance sheet management – successful organizations start and end the planning process with a solid balance sheet.
4. Competitive capital structure – the “right” capital structure supports strategic financial goals, while optimizing flexibility and minimizing cost.
5. Integrated planning process – best practice financial management aligns an organization’s long-range strategic, financial, and related planning processes.
6. Capital allocation – capital investment opportunities should be evaluated based upon consistent analysis and consideration of project risk.
7. Measurement and accountability – these ensure continued competitive financial performance against plan.

## Common Mistakes that Erode the Effectiveness of Corporate Finance-Based Management

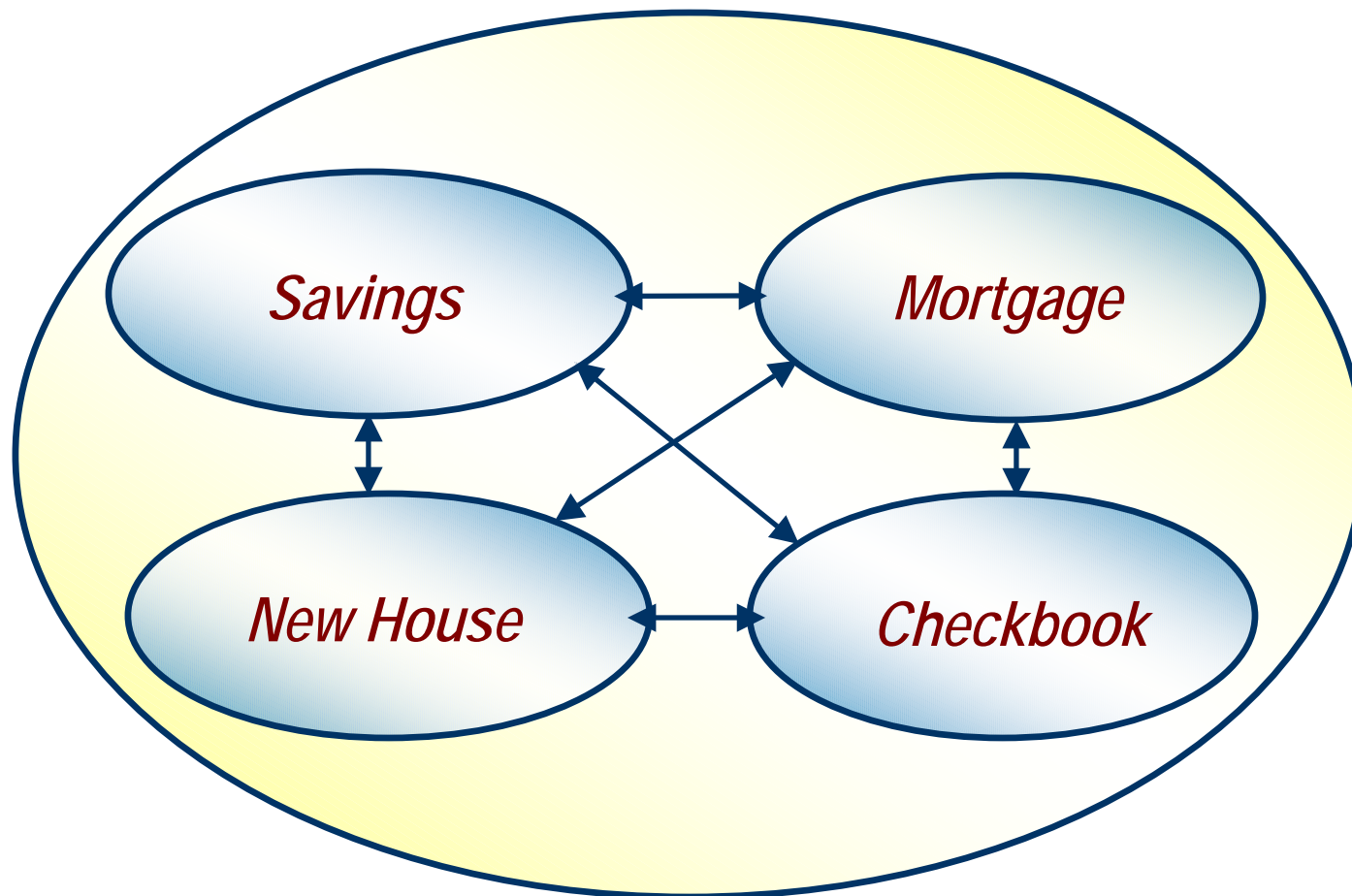
- Failure to integrate the planning and capital allocation processes
- Being a budget-based organization instead of driven by the financial plan
- Spending more than is supported by financial performance and credit position
- Failure to manage capital structure
- Failure to effectively monitor the four points of financial control
  - Cash / debt / profitability / capital spending

## Four Points of Financial Control



*How much cash, debt, capital and profitability will be required to fund strategic plans and maintain the long-term financial integrity of the organization?*

## Four Points of Financial Control



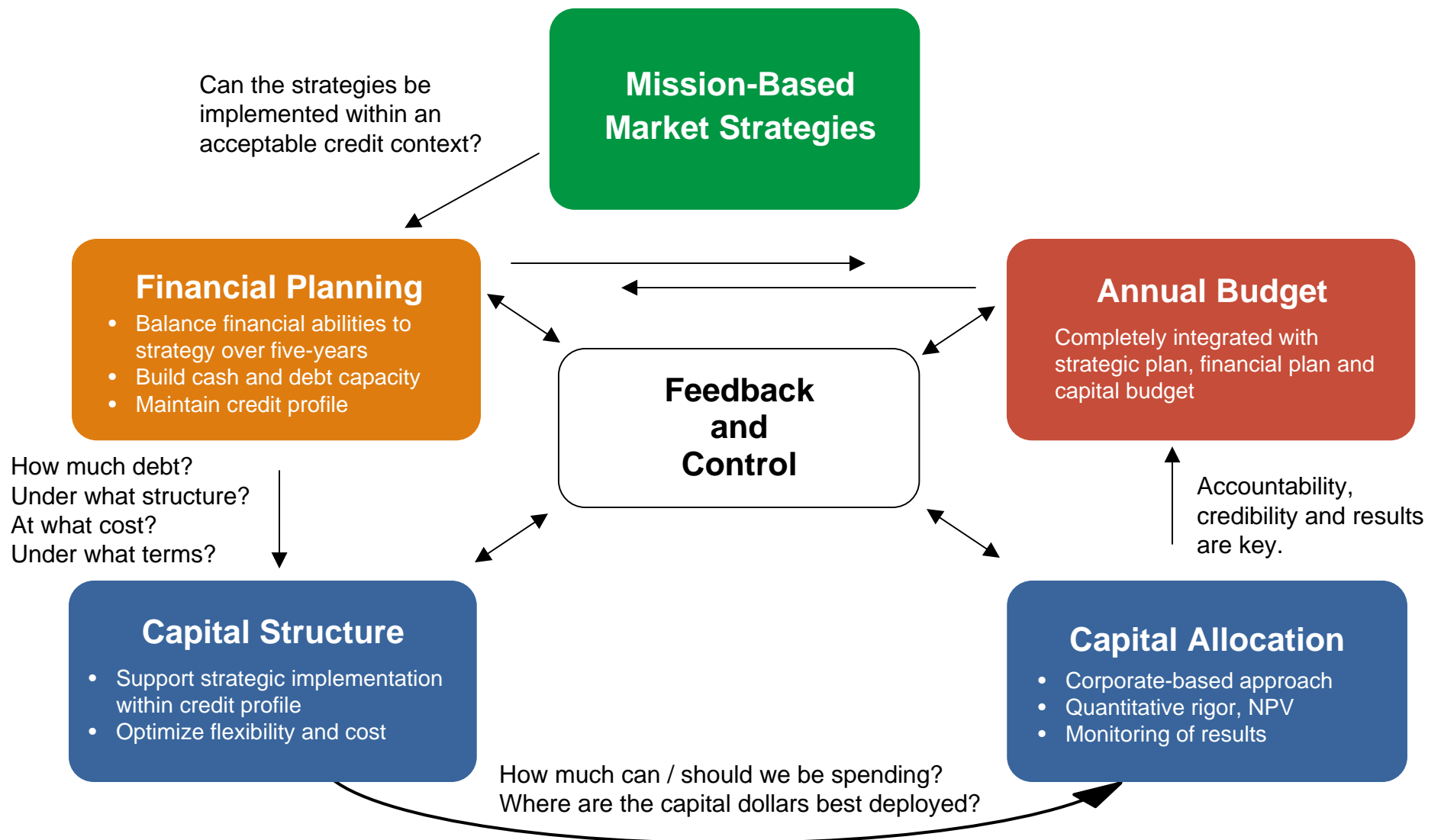
*If the Checkbook (Operations) cannot add to Savings (Cash), then there are less dollars available for a New House (Capital) or a Mortgage must be issued (Debt).*

**It's just like putting together a large puzzle.**

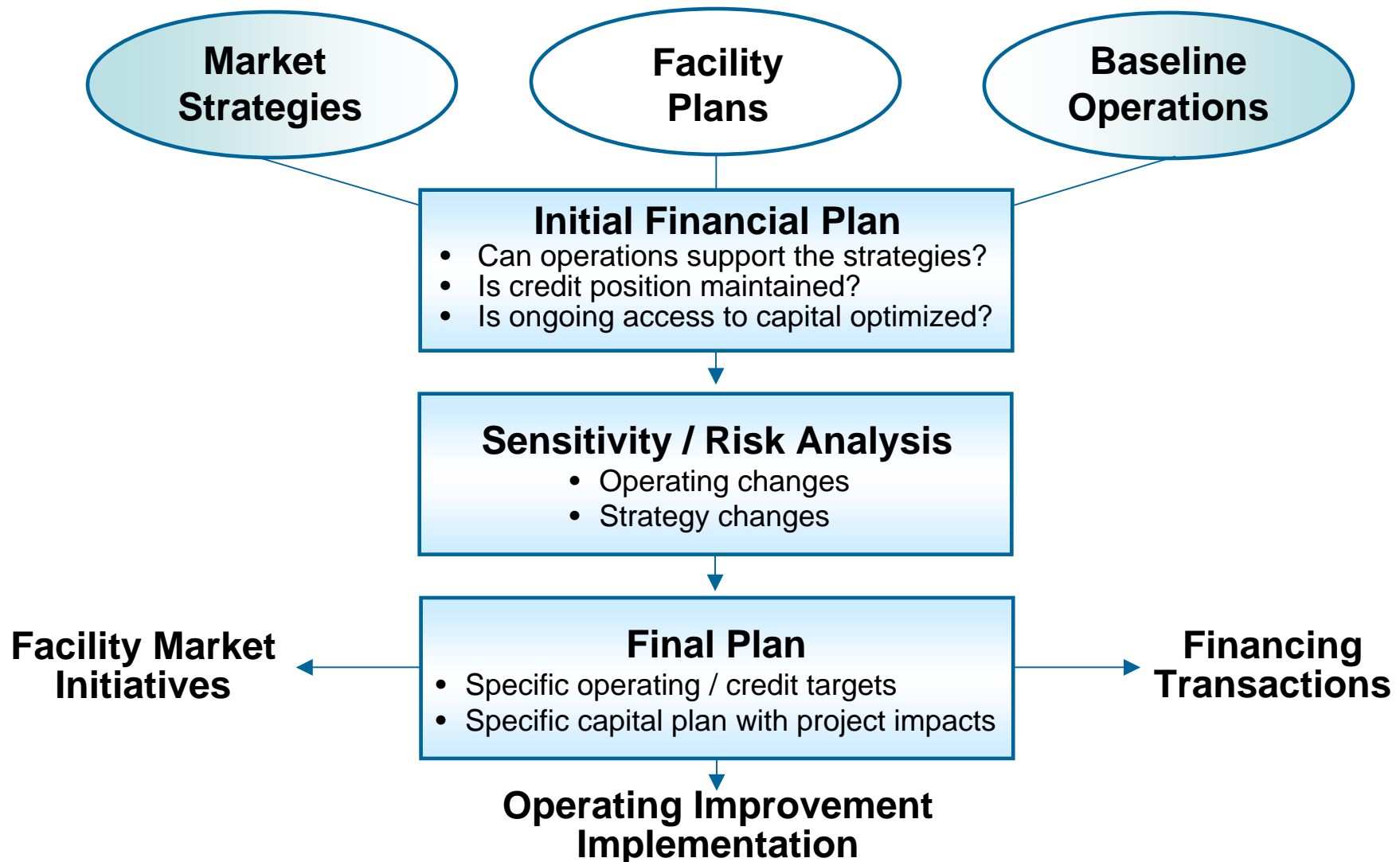


Let's start with the outside  
framework...

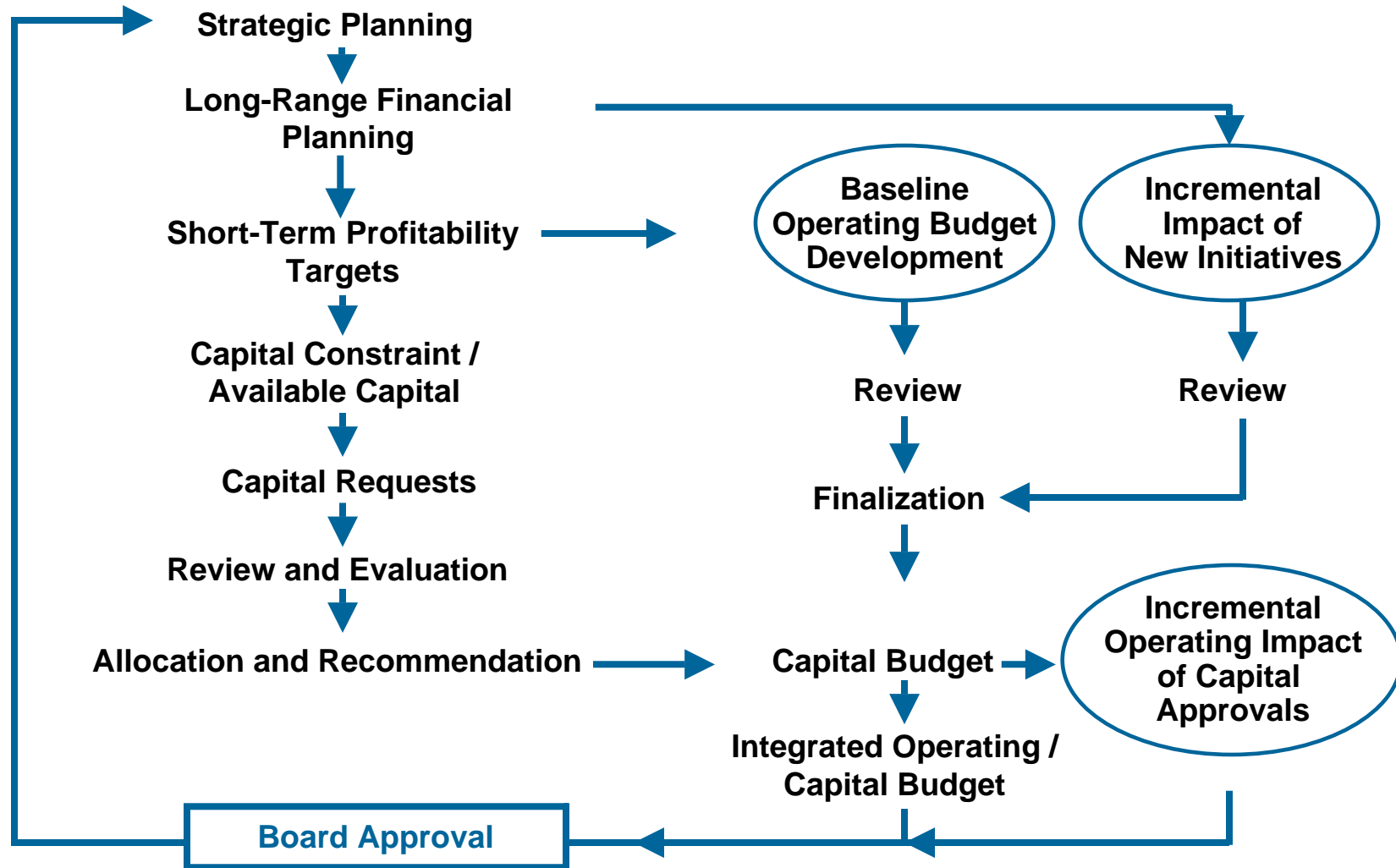
## Integrated Planning with a Corporate Finance-Based Discipline



## Integrated Planning with a Corporate Finance-Based Discipline *(continued)*

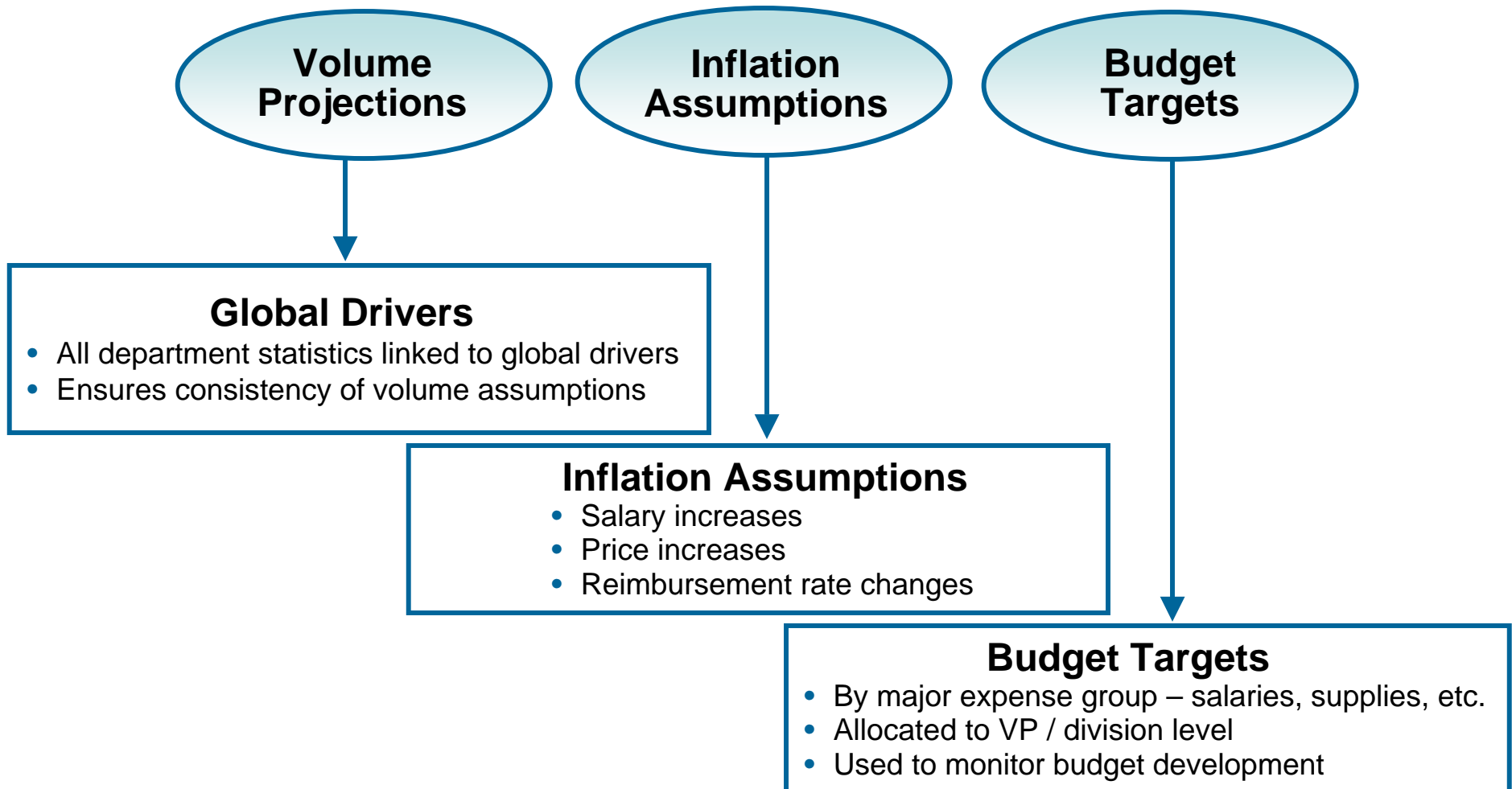


## Creating an Integrated Planning Culture Through Calendar Management



## Outputs of the Financial Plan

### Provide the Framework for the Baseline Budget Process



## Communicate, Communicate, Communicate....

1. Set aside time to share assumptions of the strategic and financial planning process with directors and managers
2. Gather feedback from directors and managers
  - What is happening in your department(s) to help us achieve the strategic plan?
  - What is happening in your department(s) to prevent us from achieving the strategic plan?
3. Test strategic and financial plan with feedback
  - This step will be invaluable in transferring ownership of the strategies for implementation to “front-line” management



## Development of Budget Targets

Financial plan targets are allocated to Vice President level

- Example: total salaries = \$100 million
  - ✓ Allocation to Vice Presidents
    - Susan Smith - \$70 million
    - Charlie Credit - \$20 million
    - Doug Jones - \$10 million
- Basis for allocation can be current year actual, budget, last year
- Adjustments to allocation basis can be made before dollars are allocated



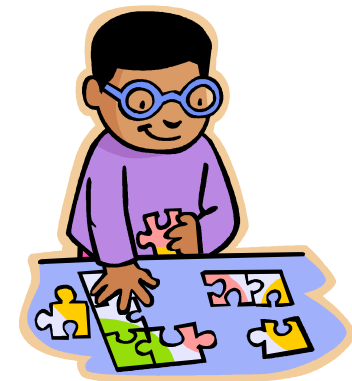
## Development of Department Statistics

- Each department has a primary statistic tied to a global driver defined by the financial plan
  - Inpatient volume driven by total patient days
  - Outpatient volume driven by outpatient visits
- Department statistics are generated using these relationships based on “today’s” statistic per global driver
  - Inpatient lab tests per patient day
  - Outpatient lab tests per outpatient visit
- As global drivers change, so do related department statistics



## Development of Department Expenses

- Each department budget is driven by per unit indicators
  - Cost per unit
  - Worked and paid hours per unit
- Link global driven volume to per unit indicators
  - Projected lab tests x cost per lab test + inflation
- Non volume-related expenses projected
  - Historical basis
  - Zero-based budget



## Monitoring Budget Targets

- Reports generated by Vice President to compare target to operating budget as it is being developed
  - Periodic feedback ensures that overages will be dealt with before “first pass” review
  - Minimizes shortfalls that often occur after budget “first pass”
  - Significantly shortens timeframe for budget completion
  - Attention can be focused on outliers and areas of major change



## Evaluating New Initiatives

- Incremental impact of new initiatives developed parallel to operating budget
  - Allows incremental analysis of impact of new initiative
  - If an initiative is denied, budget dollars are easily identified and removed from the budget
  - Baseline operations budget development is clearer and more defined (less variation)



## Operating Impact of Capital Approvals

- Incremental impact of capital approvals developed parallel to operating budget
  - Allows incremental analysis of operating impact of capital approval
  - If a capital item is denied, budget dollars are easily identified and removed from the budget
  - Baseline operations budget development is clearer and more defined (less variation)



## Putting It All Together

Baseline Operating Budget

+

New Initiatives

+

Operating Impact of Approved Capital

=

**Total Operating Budget**



## Integration with the Financial Plan

- Update financial plan with completed total operating budget
- Update financial plan with completed capital allocation budget
- Quantify impact to balance sheet and financial ratios
- Quantify long-term impact of new relationships identified in budget process
- Integrated financial plan ready for presentation to Board of Directors

**When done properly, all of the pieces fit neatly together, enabling the organization to achieve it's strategic mission.**



## Flexible Budget

Budget to Actual variances can be separated into 3 categories:

- 1.) Volume Variances – actual volume was greater or less than budget
  
- 2.) Rate Variances – average cost per procedures was greater or less than budget
  
- 3.) Efficiency Variances – mix of staffing or average time per procedure was not optimal.

## Flexible Budget

- Purpose of a flexible budget:

To analyze the impact of volume changes on your budget for those accounts that normally "flex" or change in proportion to volume changes.

- Volume variances are the most common explanation for a budget-to-actual variance
- Removing volume variance forces the manager to look at controllable factors
  - Rate – How much does it cost to provide services on a per-unit basis?
  - Efficiency – Are we providing services in the most cost-efficient manner?
- Introduces the concept of cost per unit and worked hours per unit as well as fixed and variable expenses

## Flexible Budget

- Flex Budget =  $\frac{\text{Annual Budget \$}}{\text{Annual Volume}} \times \text{Actual Volume}$
- Removes volume variance which is “noncontrollable” by managers
- Allows managers to focus on rate and efficiency variances which are within their control
- Assists in differentiating Fixed vs Variable expenses
- Per unit focus
  - Worked hours per unit
  - Total expense per unit

## Monthly department budget variance report Summary information

Current Month - May						
May-07 Actual	Actual Per Unit	May-07 Flex Budget	Flex Budget Per Unit	Variance	May-07 Budget	Account Number    Account Description

### SUMMARY INFORMATION

121	0.25	121	0.32	-	168	1 IP Cases
368	0.75	368	0.68	-	351	2 OP Cases
<b>489</b>		<b>489</b>		-	<b>519</b>	<b>Total Volume</b>
4,457	9.11	2,147			2,980	Inpatient Revenue
106,334	217.45	106,187			101,281	Outpatient Revenue
<b>110,791</b>	<b>226.57</b>	<b>108,333</b>			<b>104,262</b>	<b>Total Patient Revenue</b>
50,373	103.01	50,821	103.93	448	53,294	<b>Operating Expenses</b>
3,473	7.10	4,077	8.34	604	4,077	Salaries & Wages
5,263	10.76	3,903	7.98	(1,360)	4,143	Benefits
987	2.02	713	1.46	(273)	713	Medical Supplies
22,330	45.67	22,368	45.74	38	22,368	Other Supplies
96	0.20	216	0.44	120	216	Lease and Rental
101	0.21	168	0.34	67	168	Maintenance and Repairs
19	0.04	9	0.02	(9)	9	Other Expenses
<b>82,642</b>	<b>169.00</b>	<b>82,276</b>	<b>168.25</b>	<b>(366)</b>	<b>84,988</b>	<b>Total Operating Expenses</b>

Flex budget based on volume

## Monthly department budget variance report Per-unit summary



**Per-unit  
indicators**

Current Month - May						
Actual Per Unit	May-07 Flex Budget	Flex Budget Per Unit	Variance	May-07 Budget	Account Number	Account Description
<b>*** Per Unit Summary ***</b>						
226.57		221.54	5.03	200.89		Revenue Per Unit
169.00		168.25	(0.75)	163.75		Expense Per Unit
3.76		3.02	(0.74)	3.02		<b>Worked Hours Per Unit (TARGET = 3.02)</b>
4.41		3.60	(0.81)	3.57		Paid Hours Per Unit
\$23.35		\$28.88	\$5.52	\$28.80		Average Hourly Rate

### Reportable Variances- Please contact your Executive Lead by June 20, 2007

			(366)	(.45%)	A.) Total Expense Variance greater than \$5,000 and 5%
169.00		168.25	(0.75)	(.45%)	B.) Actual Cost Per Unit Exceeds Flex Budget by 5%?
3.76		3.02	(0.74)	(24.37%)	C.) Actual Worked Hrs Per Unit Exceeds Flex Budget by 5%?

## Department Statistics

- Department Statistics should reflect volume and intensity of services
- Statistics should be the measure of output of the department
  - Keep it simple
  - Start with statistics that are readily available
  - Benchmark services are a good way to identify what to use for the primary statistic
- Billing data is a good source but it needs to be “massaged”
- Ultimate goal is to apply Relative Value Units (RVU) to reflect intensity of service
  - Example: Neurosurgery vs Appendectomy
  - Billing Count will be one for each
  - RVU would weight that count to be 5X for Neuro and 1X for Appendectomy
- Provides more realistic measurement of services provided and resources used

## Monthly department budget variance report Staffing information

Current Month - May							
May-07 Actual	Actual Per Unit	May-07 Flex Budget	Flex Budget Per Unit	Variance	May-07 Budget	Account Number	Account Description
							<b>Staffing Information</b>
<b>8.35</b>		<b>8.35</b>		-	<b>8.86</b>		<b>TARGET - Worked FTEs</b>
10.38		8.35		(2.03)	8.86		Total Worked FTEs
(2.03)		0.00		2.03	-		Variance from Target
12.18		9.93		(2.24)	10.45		Total Paid FTEs
1,839	3.76	1,479	3.02	(397)	1,569		Total Worked Hours
2,157	4.41	1,760	3.60	(397)	1,851		Total Paid Hours
							<b>Paid FTEs by GL Code</b>
10.37		8.15		(2.22)	8.65		910000 FTEs - Regular
0.01		0.20		0.19	0.21		911010 FTEs - Overtime
1.36		1.36		(0.00)	1.36		912020 FTEs - Paid Time Taken
0.44		0.23		(0.21)	0.23		913030 FTEs - NonProductive
<b>12.18</b>		<b>9.93</b>		<b>(2.24)</b>	<b>10.45</b>		<b>Total Paid FTEs by Job Class</b>

**What change  
will get me to  
my target?**

## Monthly department budget variance report Reportable variances

Current Month - May						
Actual Per Unit	May-07 Flex Budget	Flex Budget Per Unit	Variance	May-07 Budget	Account Number	Account Description

**Highlights key reportable variances**

\*\*\* Per Unit Summary \*\*\*

	21.54	5.03	200.89		Revenue Per Unit
	168.25	(0.75)	163.75		Expense Per Unit
	3.02	(0.74)	3.02		<b>Worked Hours Per Unit (TARGET = 3.02)</b>
4.41	3.60	(0.81)	3.57		Paid Hours Per Unit
\$23.35	\$28.88	\$5.52	\$28.80		Average Hourly Rate

**Reportable Variances- Please contact your Executive Lead by June 20, 2007**

		(366)	(.45%)	A.) Total Expense Variance greater than \$5,000 and 5%
169.00	168.25	(0.75)	(.45%)	B.) Actual Cost Per Unit Exceeds Flex Budget by 5%?
3.76	3.02	(0.74)	(24.37%)	C.) Actual Worked Hrs Per Unit Exceeds Flex Budget by 5%?

## Reportable Variances

- Reportable variances are generated in three categories:
- A. Total expense variance greater than \$5,000 and 5%
  - Actual expenses in the current month or on a year-to-date basis exceeded the flexible budget by \$5,000 and 5% or more
  - If you have an expense variance of \$5,000, which is less than 5%, it is not reportable
  - If you have an expense variance of 5%, which is less than \$5,000, it is not reportable

## Reportable Variances

- B. Actual cost per unit exceeds flex budget by 5%
  - Actual total department expense per unit in the current month or on a year-to-date basis exceeded the flexible budget by 5% or more

$$\frac{\text{Total expenses}}{\text{Total volume}} = \text{cost per unit}$$

- Total department expenses include salaries, contract labor, supplies, purchased services, and other expenses
- It may also include benefits and depreciation expense depending on your accounting practices

## Reportable Variances

- C. Actual worked hours per unit exceeds flex budget by 5%
  - Actual total department worked hours per unit in the current month or on a year-to-date basis exceeded the flexible budget by 5% or more

$$\frac{\text{Total worked hours}}{\text{Total volume}} = \text{worked hours per unit}$$

- Total worked hours include regular pay, overtime, education / orientation, callback, and contract labor
- It does not include paid time off, jury duty, bereavement, or military leave

# Executive Level Reporting – Variance Summary Report

Memorial Health System Budget Variance Summary Report Year to Date - February 28, 2007			A		B				C				
Dept	Description	Director	Cur Month Expense Variance	YTD Expenses Variance	Feb-07 Actual Cost/Unit	YTD Actual Cost/Unit	YTD Budget Cost/Unit	Cost Per Unit Variance	%Cost Per Unit Variance	YTD Actual Hours/Unit	YTD Budget Hours/Unit	Hours Per Unit Variance	%Hours Per Unit Variance
26340	CCU	Bridget Clark	(41,494)	(7,005)	904.60	712.67	708.02	(4.65)	(0.66%)	21.33	23.02	1.69	7.36%
46540	Restorative Care Unit (4B)	Carla Hughes	22,335	67,887	389.24	390.88	404.17	13.29	3.29%	13.76	13.91	0.15	1.11%
46860	Speech Therapy	Carla Hughes	976	3,830	14.57	29.80	45.56	15.76	34.59%	-	-	-	0.00%
47370	Rehab Svcs	Carla Hughes	9,518	63,611	1,467.38	1,390.11	1,651.88	261.77	15.85%	13.09	12.94	(0.14)	(1.12%)
47640	Surgery	Carla Hughes	9,577	41,861	220.18	346.01	518.28	172.27	33.24%	-	-	-	0.00%
26100	Nursing Administration	Denise Love	(31,027)	(113,120)	4,377.43	3,556.27	3,090.76	(465.51)	(15.06%)	99.55	200.54	100.99	50.36%
26550	PICU	Denise Love	312	(291)	289.01	641.94	631.54	(10.40)	(1.65%)	19.41	-	(19.41)	0.00%
26760	Women Services	Douglas Houseton	(3,849)	(22,471)	655.24	565.36	472.89	(92.47)	(19.56%)	11.36	15.36	4.00	26.05%
26230	CVS	Jane Slater	(25,827)	(86,974)	1,592.43	1,640.04	1,491.36	(148.67)	(9.97%)	49.38	45.76	(3.62)	(7.91%)
26320	3 West	Jane Slater	(15,327)	(103,262)	280.09	275.91	260.48	(15.43)	(5.92%)	10.87	11.53	0.66	5.72%
26350	AICU	Jane Slater	(26,418)	(392,940)	663.32	682.47	568.81	(113.67)	(19.98%)	21.96	22.12	0.16	0.73%
26430	Well Baby Nursery	Jane Slater	277	19,802	127.75	105.67	119.16	13.49	11.32%	3.11	3.78	0.67	17.82%
26470	4 East	Jane Slater	(182,583)	(848,358)	380.11	293.71	82.73	(210.98)	(255.04%)	10.87	13.64	2.78	20.34%
27770	Geriatric Programs	Jennifer Gray	9,032	18,488	315.25	350.14	426.22	76.08	17.85%	13.73	10.56	(3.18)	(30.10%)
27800	Recovery Services	Jennifer Gray	(33,920)	(285,166)	205.71	214.00	175.34	(38.66)	(22.05%)	6.73	4.95	(1.77)	(35.83%)
27805	Geropsych	Jennifer Gray	(5,454)	(49,340)	322.05	320.36	298.69	(21.67)	(7.25%)	10.32	10.47	0.15	1.44%
27810	Partial Program	Jennifer Gray	(3,473)	(17,109)	226.32	252.34	231.45	(20.89)	(9.03%)	6.33	6.13	(0.20)	(3.29%)
26790	Same Day Surgery	Jo Hudson	(34,393)	(12,311)	96.12	86.48	85.37	(1.11)	(1.30%)	2.72	2.74	0.02	0.79%
27640	Surgery	Jo Hudson	(180,021)	(17,337)	18.96	17.33	17.31	(0.02)	(0.14%)	0.19	0.20	0.01	4.66%
26780	Heart Services	Julie Prestridge	(7,139)	(63,335)	896.46	812.42	551.78	(260.64)	(47.24%)	12.50	15.98	3.48	21.81%
26480	O/P Oncology	Kerrie Wood	3,983	5,437	52.24	50.40	51.96	1.56	3.01%	1.25	2.23	0.98	44.10%
26750	Breast Health Center	Kerrie Wood	24,614	187,208	150.16	149.59	209.50	59.91	28.60%	2.19	2.86	0.67	23.47%
26850	Labor And Delivery	Lenoria Myers	13,963	(44,541)	764.64	768.04	747.44	(20.60)	(2.76%)	23.89	26.28	2.40	9.12%
26450	NICU	Lynette Byrd	(106,251)	(90,158)	553.59	461.98	440.13	(21.85)	(4.96%)	11.17	19.45	8.29	42.60%
26140	Emergency Room	Mitchell Erving	(51,939)	(618,441)	86.47	82.40	63.94	(18.46)	(28.87%)	2.67	2.81	0.14	4.99%
26150	Emergency Room-Physicians	Mitchell Erving	(50,295)	(350,295)	3,475.12	2,989.16	1,547.61	(1,441.54)	(93.15%)	-	-	-	0.00%
46790	Same Day Surgery	Nancy Judy	-	(92)	-	0.38	-	(0.38)	0.00%	-	-	-	0.00%
<b>Total</b>			<b>(704,822)</b>	<b>(2,714,424)</b>									
Variance Threshold			\$5,000 and 5%	\$5,000 and 5%					5.00%				5.00%

## Managing your department

- Treat your OPERATING budget like your checkbook at home
  - If you don't need it, don't buy it.
  - If you don't have the money, don't spend it.
  - If something unexpected occurs, what do we do without?
- Treat your CAPITAL budget like your checkbook at home
  - How does this expenditure fit into the "Master Plan"?
  - If you don't need it, don't buy it.
  - If you don't have the money, don't spend it.
  - If something unexpected occurs, what do we do without?
  - If dollars are limited, what is most important?

**Questions?**