FOURTH EDITION

HEALTH CARE FINANCE

Basic Tools For Nonfinancial Managers

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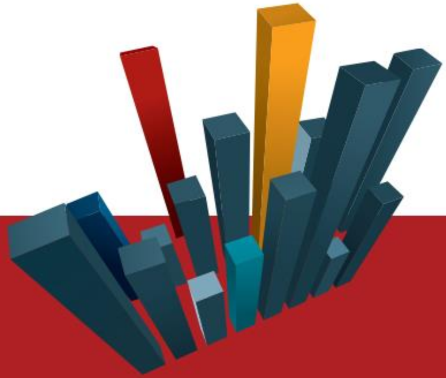

Part VI: Construct and Evaluate Budgets

CHAPTER 15: OPERATING BUDGETS

Budget Types

- An organization's objectives define
  - specific activities,
  - how they are assembled,
  - levels of operation,
- While an organization's performance standards set out performance levels.
- A budget quantifies these activities into financial terms.

Budget Process Objectives

- Objectives should provide:
- Written expression, quantified, of policies and plans
- Basis to evaluate financial performance according to policies and plans
- Useful tool for cost control
- Creation of cost awareness throughout the organization

Budget Types

- There are basic differences between two budget types:
- Operating budgets
- Capital expenditure budgets

Operating Budgets

- Deal with actual short-term operating revenues and operating expenses
- Generally cover the next year (a 12-month period)

Capital Expenditure Budgets

- Deal with capital expenditures for the organization (not operating revenues or expenses)
- May also cover the next year, but with a futuristic view; may cover a five or even ten year period

Responsibility Centers

- Cost Centers (manager responsible for controlling costs)

or

- Profit Centers (manager responsible for both costs and revenue)

Budget Viewpoints

- Transactions outside the operating budget may include:
  - Grants received by the organization
  - Foundation transactions
- So if transactions are “outside”, they would not be part of the operating budget.

Budget Viewpoints

- Grants received by the organization may have restricted funds that require separate accounting
- If so, the separate accounting requirement generally means their transactions will be outside the operating budget

Budget Viewpoints

- Foundation transactions should require separate accounting because the foundation will be a legally separate organization
- And the separate accounting requirement should mean their transactions will be outside the operating budget

Identifiable Versus Allocated Budget Costs

- Within a departmental budget certain costs will be specifically identifiable while others will be allocated instead.

Budget Basics Review

- Regarding Identifiable versus Allocated Budget Costs:
- Mostly identifiable = Direct patient care and supporting patient care
- Usually allocated = general and administrative expense and patient related expense
- Maybe not included at all in a manager's budget = financial related expense

Fixed Versus Variable Costs

- Variable cost rises or falls in proportion to a rise or fall in volume (Examples of volume: number of procedures or number of patient days.)
- Fixed cost does not change even though volume rises or falls within a wide range

Exhibit 15–1 Fixed and Variable Cost Examples

Operating Expenses	Fixed	Variable
Labor		
Gross Salaries	X	
Employers' Payroll Taxes	X	
Other Employee Benefits	X	
Part-Time Temporary Contract Labor		X
Other Expenses		
Drugs and Medical Supplies		X
Rent	X	
Insurance	X	
Five-Year Equipment Lease	X	

Building an Operating Budget: Construction Phases

- Plan
- Gather information
- Prepare input
- Construct/submit draft version of budget
- Make required revisions to draft
- Present preliminary budget
- Make required revisions to preliminary
- Submit final budget

Building an Operating Budget: Construction Elements

- Format to be used
- Budget scope
- Available resources
- Levels of review
- Time frame

Building an Operating Budget: Information Sources

- For the Operating Expenditures Plan:
  - Operating Revenue Forecast
  - Staffing Plan or Forecast
  - Other Operating Expenses
- For the Preliminary Operating Budget:
  - Capacity Level Checkpoints
- See Figure 15-5

Building an Operating Budget: Assumptions

- A series of assumptions are made during construction; many key assumptions are within forecasts used for the budget construction process
- Sufficient information at the proper level of detail is essential

Building an Operating Budget: Assumptions: Questions to Ask

- Are special projects going to use resources during the new budget period?
- Are operations going to be placed under unusual or inconvenient circumstances during the new budget period? (Renovation is an example.)

Building an Operating Budget: Computations

- Supported by their assumptions
- Capable of being replicated or reproduced by another qualified individual
- Comparable (as discussed in the text)
- Budget assumptions and computations are intertwined in the construction process.

Static Budgets

- Are essentially based on a single level of operations. That level of operations — or volume — is never adjusted during the budget period.
- See example in Table 15-4
- It doesn't move - therefore it is "static".

Flexible Budgets

- Are based on a level of operation that will change. In other words, the level of operations — or volume — is adjusted to show change during the budget period.
- See example in Table 15-5
- It is adjusted, or flexed - therefore it is "flexible".

Budget Review

- To review a budget, the manager needs to know
- How the budget report format is constructed
- How to annualize partial year expenses
- More details are in the chapter.

Building Budgets

- The budget process should begin with a review of the strategy and objectives.
- Remember, building a budget means making a series of assumptions.

Building Budgets

- To build a budget, a manager must consider
- The workload forecast (it must tie into the forecasted volume)
- Whether budget projects will use resources during the budget period.
- Whether budget operations will be placed under unusual or inconvenient circumstances during the budget period (remodeling, for example).

Budget: Example 15-A

Step 1.

	Actual
Revenue	$21,600,000
Expenses	22,000,000
Excess of Expenses over Revenue	$ (400,000)

Step 2.

	Budgeted
Revenue	$24,000,000
Expenses	22,400,000
Excess of Revenue over Expenses	$ 1,600,000

Step 3.

	Actual	**Budgeted**	**Static Budget Variance**
Revenue	$21,600,000	$24,000,000	$(2,400,000)
Expenses	22,000,000	22,400,000	(400,000)
Excess of Expenses over Revenue	$ (400,000)	$ 1,600,000	$(2,000,000)

Budget Practice Exercise 15-I

Step 1.	Actual
Revenue – Inpatient	$17,550,000
Revenue – Outpatient	4,400,000
Subtotal	$21,950,000
Expenses – Inpatient	$16,100,000
Expenses – Outpatient	4,000,000
Subtotal	$20,000,000
Excess of Expenses over Revenue	$ 1,850,000

Step 2.	Budgeted
Revenue – Inpatient	$19,500,000
Revenue – Outpatient	4,000,000
Subtotal	$23,500,000
Expenses – Inpatient	$18,000,000
Expenses – Outpatient	3,800,000
Subtotal	$21,800,000
Excess of Expenses over Revenue	$ 1,700,000

Step 3.	Actual	Budgeted	Static Budget Variance
Revenue – Inpatient	$17,550,000	$19,500,000	$(1,950,000)
Revenue – Outpatient	4,400,000	4,000,000	400,000
Subtotal	$21,950,000	$23,500,000	$(1,550,000)
Expenses – Inpatient	$16,100,000	$18,000,000	$(1,900,000)
Expenses – Outpatient	4,000,000	3,800,000	200,000
Subtotal	$20,000,000	$21,800,000	$(1,700,000)
Excess of Expenses over Revenue	$ 1,850,000	$ 1,700,000	$ 150,000