This paper describes an approach to budgeting that integrates strategic and financial planning, capital planning, and a “connected” budget development process. This “best practice” budgeting process establishes budgeting as an integral part of the financial management cycle. The direct link between strategy-level plans and day-to-day operations is critical to ongoing organizational success.

Does your organization integrate budget development with the results of its strategic and financial plans? Are individual budgets prepared with an understanding of the impact of that budget on the organization's overall financial position?

Kaufman Hall White Paper

STRATEGIC BUDGETING
A HEALTHCARE IMPERATIVE

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The budgeting process. Often the bane of existence for healthcare financial managers, it can be a time consuming and unfulfilling process involving confrontation, negotiation and politics. For some organizations, budgeting fully consumes half of the fiscal year. The effect? The organization’s financial management team and tools are essentially unavailable to support key strategic needs. In addition, the final budget often is not in line with the organization’s short and long-term strategic financial interests. Such misapplication of organizational resources might be tolerated in an era of healthy reimbursement, inter- and intra-organizational subsidization, and easy access to capital. However, in the current climate of intense competition, constrained reimbursement, and increasing costs, decision making in healthcare organizations must be fully supported by a top-notch financial team, comprehensive financial analysis, and a well-integrated strategic financial plan.

This paper describes an approach to budgeting that integrates strategic and financial planning, capital planning, and a “connected” budget development process. Organizations that have adopted a corporate finance management philosophy understand and apply this approach as a basic component of their ongoing decision making. Its foundation lies in the explicit quantification of the organization’s strategies into operating and capital plans that are framed by specific, measurable targets and objectives. The best practice budget translates strategies directly to operating targets. Both non-financial and financial managers then monitor and measure performance against those targets. As a result, they are well equipped to proactively identify trends that require attention in order to ensure the organization’s ongoing strategic financial success. How is this different than the budget approaches that many healthcare organizations currently have in place?

THE STANDARD APPROACH TO BUDGETING

The healthcare industry’s “typical” approach to budgeting can be characterized as a combination “top down/bottom up” process. Essentially, executives at the senior management level centrally establish all significant budget targets, but the actual budget is completed at the departmental level. The “top down” portion of the budgeting process occurs as a first step when the leadership team sets annual profitability targets. For organizations not engaged in corporate finance-based strategic financial planning, this typically resembles more of an art than a science. In some organizations, this year’s budget target is based on last year’s performance. Others set their targets based on information gleaned from various industry periodicals. Still others use the profitability levels achieved by peer organizations and competitors as a guide to their own targets. In any case, the targets established by senior leaders are not necessarily consistent with the organization’s strategic goals and related capital needs.

To make the process “efficient,” budget directives are passed down to department managers. Because there is limited communication, operations-level staff (the people who make the budget happen) are uninformed about why targeted levels of operations are necessary vis-à-vis the organization’s overall strategy. With limited understanding of the strategic foundation for the budget targets, there’s no basis to gain support for the overall budget from operations-level staff.
Having established the overall budget targets, the “bottom up” portion of the process begins as staff embark on a multi-month exercise to develop the detailed annual budget. Department managers submit budget requests for the coming year based on budget directives provided by senior leaders. Unfortunately, because such individuals may be disconnected from and uninformed about the organization's overall strategic and financial goals for the coming year, the proposals often reflect individual departmental requirements. The proposals may

- purposefully overestimate expenses in order to ensure that the department retains sufficient budget dollars following the inevitable negotiations to pare initial budget requests;
- underestimate expenses due to lack of awareness of new strategic directions or expansion plans that will impact their portions of the operation;
- “low ball” expenses so that new strategic initiatives emerging during the year must be funded by other parts of the organization; or
- present a “pie in the sky” wish list.

This invariably results in an initial budget that is way off the mark. For example, if senior management expected an expense budget of $100 million, the initial requests are likely to be in the $130 to $150 million range.

Thus, step three of the approach–the paring or cutting and negotiation process–begins. Financial leaders try to determine what each department manager “really needs” to run his or her operation. A clarification process ensues, complete with frequent, confusing, sometimes acrimonious, and time-consuming meetings. Participants slog through this stage, which often gets so convoluted that many lose faith in the numbers that emerge. A huge amount of time is invested by all those with a stake in the budget.

By providing department managers with the strategic context for concrete guidelines or targets, all managers can fully understand the consequences of meeting or not meeting the established targets.

THE NEED FOR IMPROVEMENT

So, how do we fix this process to achieve better results? A common response is to simply shorten the time frame of the existing process by reducing the scope of participation and centralizing departmental budgeting. Essentially, this response says, “Don't change the process; just push the organization more to a top-down approach.” Using this approach, budgets can be created very efficiently and look great on paper. But inevitably, cost variances and overruns wreak havoc with expected financial performance. The organization has very limited ability to make valid comparisons of its budget “plan” to actual operating results. Thus, while the condensed approach creates the appearance of a more efficient process, the end product is not an improved one.

While only some organizations perform strategic and financial planning, all healthcare organizations prepare a budget. So the need to fix the standard budget process is acute. A budget alone does not provide real financial guidance. The organization must ask whether it integrates budget development with strategic and financial planning. Also, are individual budgets prepared with an understanding of the impact of that budget on the organization’s overall financial position?

All too often, the budget-strategy disconnect reflects the age-old antipathy between planning and finance based on the perception of finance as a roadblock to the organization's creativity. In other instances, the separation reflects a management approach that simply does not embrace the concept of integrated planning. Regardless of the reason, the result is a budget that does not support the organization’s strategic vision.
FUNDAMENTALS OF AN INTEGRATED APPROACH

A best practice approach to budgeting integrates strategic planning, financial planning, capital planning, capital allocation, and the budget development and implementation processes. The budget is an integrated implementation plan that directly connects the organization's mission and strategic objectives to the day-to-day efforts of its staff.

Integrated budgeting is essential to management's active control and direction of the financial management cycle (Figure 1). This cycle is central to the success of such companies as General Electric, which pioneered best practice financial management based on the principles of corporate finance. The cycle includes three major planning functions that are integrally connected: strategic, financial, and capital planning. Plans in each area, developed in the cycle's first phase, help leaders focus on the best possible investment of the organization's resources. In the cycle's second phase, operating and capital budgets are developed and implemented, thereby “operationalizing” the planning framework. The third and final phase of the cycle focuses on monitoring and tracking the goals established during the budgeting phase. If these goals are met, so are the organization's larger planning objectives. Relevant data related to operating performance are fed back to those performing the planning function as the cycle re-commences for the next fiscal year.

Each phase of the cycle is a vital component of the larger whole. The multi-year strategic plan incorporates specific market initiatives for the coming year. The financial plan quantifies the potential capital and operating requirements of those strategies and establishes the annual financial targets required to fund the proposed strategies. The operating and capital budgets, developed based on the financial and strategic plans, outline specific recommendations for investing capital needed to implement specific strategies and outline implementation costs in relation to income. Recommendations are consistent with targeted cash flow and short and long-term strategic financial plans. The annual budgets effectively provide a direct link to day-to-day operations. Who is responsible for a best practice budgeting process? Because the planning and budgeting processes are fully integrated, responsibility for development and
implementation of the budget spans the entire organization. This enables the finance staff to apply its resources effectively and efficiently in order to support organizational decision making. Successful financial management can no longer be focused solely on measuring past performance (i.e., accounting and reimbursement). The finance function must provide a framework for the organization to generate sufficient internal and external capital to support its strategic needs. Financial leaders must ensure that the necessary processes are in place to enable managers to convert the organization’s overall financial objectives into “on the ground” operating targets.

**BUILDING A STRATEGIC BUDGET**

A best practice approach to financial management involves multiple steps that are integrally related. It begins with the target-driven process embodied in a top-down approach to strategic and financial planning, but “tempers” the targets with the vast operating knowledge of department-level staff, thereby increasing the likelihood of achieving the targets.

**Step 1. Develop the Strategic and Financial Plans**

It all starts here. During the first several months of the fiscal year, senior leaders, often with the input of the board of directors, define or refine the organization’s strategic and financial goals. They identify the organization’s overall vision, strategic priorities and the financial targets to be achieved in pursuing these priorities. The strategic plan provides the goals and objectives that will enable the organization to meet its mission and outlines specific programs or services that should be pursued during the plan period. The financial plan assesses the achievability of these initiatives. It also includes specific information on such items as overall volume projections for the coming fiscal year, focusing on statistical data, such as total patient days, discharges, changes in average length of stay, outpatient volume, and surgical volume, required to meet such targets. This financial plan is completed immediately following completion of the strategic plan.

**Step 2. Communicate Objectives**

As the next step, senior leaders communicate with department managers throughout the organization about strategic and financial goals and related operating imperatives, describing how these were generated. This provides a common understanding of the organization’s overall strategy and the financial hydraulics required to make that strategy happen. Through such communication, leaders provide understandable explanations for operating or budgeting parameters, such as the need to hold staffing to current levels, increase surgical volume by A%, increase salaries no more than B%, reduce supply costs by C%, and increase patient admissions by D%. Without such explanations, staff would be likely to receive these parameters as little more than dictates. By providing department managers with the strategic context for concrete guidelines or targets, all managers can fully understand the consequences of meeting or not meeting the established targets.

**Step 3. Obtain/Provide Feedback about Targets**

Next, senior leaders give department managers the opportunity to provide feedback on the key assumptions underlying the strategic and financial targets, and managers provide such feedback. During this step, managers validate the operational practicality of the goals described in the financial plan by answering questions, such as:
What activities are occurring in my department to help the organization achieve its strategic and financial objectives for the upcoming fiscal year?

What is occurring or might occur in the department or between departments to prevent the organization from achieving its strategic and financial objectives for the upcoming fiscal year?

Interactive dialog between department managers and senior leaders about the answers to these questions enables leaders to clarify any targets whose purpose may not be clear to managers and provides an opportunity for managers to help leaders clearly define the interdepartmental impact of the defined initiatives. Dialog also effectively breaks down the “silo” mentality that typically occurs during a budgeting process. In addition, and perhaps, most importantly, dialog also expands ownership of the organization's strategic plan and creates real accountability for its operational integration.

Armed with real knowledge of the organization's strategic direction and how it applies to the coming fiscal year, department managers can provide valuable input about how the specific strategies are likely to impact their departments. For example, perhaps a health system will be starting a new women's health service or a hospital will be buying a high-end piece of diagnostic equipment expected to increase outpatient volume by 3%. What are the departmental impacts of such strategies?

Knowledge about why certain targets are needed and how they support the success of the organization helps to build operations-level buy-in. Volume projections are revised and translated by the senior team into an overall financial and capital plan that delineates specific financial targets consistent with identified strategic imperatives.

**Step 4. Develop the “First Pass” Budget**

With a best practice approach to financial management, the specific targets of the financial plan are used to “drive” initial budget development, in effect, rolling the financial plan down through the organization. During this next step, the finance team prepares a first pass budget that translates the assumptions of the overall strategy into concrete statistical targets and departmental budgets.

Statistical information drives best practice budgeting. Data related to patient volume and other organizational “drivers” are derived from the strategic, financial, and capital plan. Core data used in financial planning, such as the projected number of outpatient visits, admissions, and discharges, are integrated within individual budgets and provided to department managers.

For example, consider a hospital planning to build a new heart center in order to expand its cardiovascular services. The organization's financial plan identifies expected incremental increases in inpatient and outpatient volume associated with this initiative. The financial plan also quantifies incremental operating costs and capital expenses related to diagnostic equipment and facility construction. But how does the hospital's finance team “operationalize” this initiative for the radiology department, for example?

The team obtains data that show the relationship between inpatient and outpatient activity levels and activity levels in radiology (for example, the number of exams per average admission or the number of X-rays per average patient day). These relationships could be derived from actual data or be estimated based on the experience of others. Specific departmental costs can be identified as...
fixed or variable relative to volume. Applying these parameters, new cardiovascular admissions projected in the strategic financial plan will correlate to a specific number of radiology exams. In turn, these new exams will drive quantifiable increases in staffing, supplies, utilities, and so forth in the radiology department.

Each department has a primary cost per unit statistic that is tied to the assumptions of the overall strategy. For example, the laboratory’s core statistic is lab procedures as a percentage of patient days. Through use of software that integrates strategic assumptions with budget development, these relationships are held constant. When the leadership team indicates that patient days will go up or down, inpatient and outpatient radiology lab procedures will also go up or down on the budget provided to the radiology lab director.

Hence, this initial budget provides managers with line item budget detail tied directly to the organization’s overall financial strategy. Requirements related to new and ongoing strategic initiatives are specifically quantified.

Step 5. Review the “First Pass” Budget
At this point, department managers are asked to review the “first pass” budgets that include their department-specific targets. Because department managers now understand the link between achieving budget targets and the organization’s overall success, this review, which occurs within no more than a month-long time frame, is a strategic, critical one. The role of department managers is to identify exceptions and to define specific, measurable alternatives that will offset such exceptions in order to keep the departmental and organizational budgets balanced.

Budgeting no longer is a process of providing simple budget input sheets on which managers input departmental wish lists. Rather, managers review and adjust the first pass budget in the context of defined targets of integrated organizational and departmental performance. This “adult” process forces every manager to assume responsibility and accountability for his or her contribution to the whole. In the zero sum world of healthcare budgeting, a change in one department must be balanced with an equal and opposite change elsewhere. Each department manager must understand how his or her unit statistics interact with strategic and financial assumptions to generate the target budget. He or she must communicate, in quantitative and measurable terms, any issues that would invalidate the first pass budget.

The first round of budget review is relatively short in duration and results in the identification of any adjustments necessary to account for special situations. Items not identified as needing adjustment at this stage will remain unchanged unless truly extenuating circumstances occur. Thus, department managers must not hesitate to raise real issues or concerns at this point.

Step 6. Make Adjustments and Finalize the Budget
Working with department managers, the finance team adjusts the budget to reflect the financial impact of issues and alternatives and finalizes the budget. This step occurs approximately one month prior to submission of the final budget for approval. It should not take longer than a month because it focuses solely on those departments with issues that represent significant changes from the first pass budget. Managers of departments in which statistics, such as costs per unit or FTEs, are
stable or improving know that they are done with the budgeting process and will not need to revise data.

Step 7. Use the Budget as a Management Tool
In a best practice approach to financial management, the budget is an active tool for day-to-day management. It provides very precise guidance to all levels of the organization and is used on a regular basis. At the departmental level, monthly variance analysis assumes expanded meaning. Cost overruns or revenue shortfalls are evaluated in the context of overall organizational goals.

The connection between the budget and the organization’s financial plan must remain active throughout the year. Therefore, on a periodic basis (perhaps quarterly), senior leaders and financial managers assess year-to-date performance not only against budget, but also against the long-range financial plan. They ask such questions as:

- How does the 3% negative variance from budget after the first quarter affect the organization's ongoing ability to continue to generate the capital capacity needed to support its strategic initiatives? or
- What operating changes must be made during this fiscal year to ensure that the organization meets its long-term financial and strategic objectives?

Thus, the budget is a living, organic document, providing guidance and analytical fodder to guide the organization’s daily operations. In contrast, for many organizations using the typical approach to budgeting described earlier, at this point the budget becomes an artifact relegated to the “back shelf.” Although the finance department generates monthly responsibility reports, no specific or discernible management decisions appear to result from the analysis.

Step 8. Restart the Cycle
Following the close of one fiscal year, the cycle recommences. As Step 1, senior leaders review and update the organization’s strategic plan and Steps 2 through 6 follow.

The schedule of the best-practice approach to financial management must be rigorously followed in order to ensure the organization's ability to make consistent and timely decisions. The sidebar below illustrates a sample time frame that involves performing the entire process within several months.

Sample Time Frame for an Integrated Budgeting Process
For a July-through-June fiscal calendar, completion dates might look like the following:

- **December 1:** Complete strategic plan.
- **February 1:** Complete financial plan.
- **February 15:** Define financial expectations for next annual budget.
- **March 1:** Develop and distribute budgets for/to each department.
- **April 1:** Review of budgets by department managers.
- **May 15:** Finalization of annual budget.

An integrated budgeting process shortens the actual budget development phase by half, running from March 1 through mid May.
MAKING IT HAPPEN

Because modern day decision making must be timely, efficient, integrated, and of high quality, sophisticated budgeting software is critical. The tools that worked to support the budgeting process in healthcare organizations ten years ago simply are inadequate to meet the needs of today’s complex organizations. Contemporary software must offer a wide range of benefits to support the best practice budgeting process described in this paper, including:

- **Flexibility**: The software must address the variety of operations comprising today’s healthcare organization. If a portion of the users are “trying to fit their round peg into the software’s square hole,” the value of the tool is eliminated.

- **The ability to evolve**: The software must be able to grow with the needs of the organization. Experience shows that access to powerful tools pushes an organization to want more analytic power. The software design must be able to deliver over the long haul.

- **Calculating power**: Healthcare budgeting is built on numerous and varied calculations, ranging from unit volumes to fixed and variable expenses to complex compensation structures. The software must easily accommodate each and every type of calculation.

- **Security**: Management must be able to control distribution and access to the confidential information and detailed calculations supported by the software.

- **Analytic capability**: The software must be able to integrate the strategic and financial planning processes with the budgeting process. Its direct link to the financial plan enables users to test the short and long-term operating and balance sheet impacts of identified strategic initiatives.

- **Reporting**: State-of-the-art software must support totally flexible reporting. Best practice budgeting is all about communication of information and measurement and analysis of results to identify problems and determine solutions. From basic responsibility reporting to reporting of cost variance explanations, the software must allow the user to “slice and dice” the data in order to create management reports that focus on the issues at hand.

- **Ease of use**: To achieve the broad-based use that is critical for an integrated best practice approach, the software must be easy to use. Its structure, accessibility, design, documentation, speed, consistency, and elegance will be major factors in the level of use achieved throughout the organization. If the software requires users to learn a new platform or interact in ways that are unique to that tool, users will be less willing and able to use it. The software must be comfortable and sturdy, thereby ensuring that new users are not afraid of “breaking it.”

- **Ease of maintenance**: After the software is installed, maintenance should be minimal and easily accomplished on an ongoing basis.

Through each of these characteristics, budgeting software assures the integrity of the budgeting approach and thus, the organization’s confidence in the budgeting process. As described, decentralizing decision making and accountability are key to the success of best practice budgeting. Tools that enable managers to fully understand the implications of their decisions and measure their outcomes help achieve the level of “buy-in” needed for a successful budgeting process.
CONCLUDING COMMENT

In many organizations, healthcare budgeting remains a complex, cumbersome, time consuming, and inherently uninteresting process. At a departmental level, it often is viewed as a “we versus they” contest to protect operating dollars from the inevitable cuts that follow. Negotiations are pursued in a strategic vacuum that often renders results that are detrimental to the organization's overall goals.

In contrast, a best practice budgeting process incorporates budgeting as an integral part of the financial management cycle. All managers are educated about strategic imperatives—both market and financial—and are responsible for achieving those imperatives at the departmental level. This improved process emphasizes the importance of each operational component to the success of the whole organization. It is inclusive and flexible, yet quantitatively driven within specific rules and timing. It limits budget iterations and negotiations, yet is active and participatory. In short, use of a best practice budgeting process helps healthcare organizations ensure a direct link between their strategic and financial plans and day-to-day operations. This link is critical to their future success. An example of one organization's experience with strategic budgeting follows.

![Strategic Budgeting Diagram](image-url)

*Source: Kaufman Hall & Associates.*
STRATEGIC BUDGETING IN PRACTICE

This example describes one organization’s recent implementation of a best practice budgeting process. This process provided a framework to operationalize the organization’s strategy on a day-to-day basis.

Organization at a Glance
Part of a faith-based national health system, ABC Healthcare is a regional system serving the approximately 1.2 million residents of a major metropolitan area and its surrounding county. Generating more than $600 million in annual revenue, ABC Healthcare includes four acute care hospitals, physician clinics, a skilled nursing facility, a college of nursing, and numerous other entities.

Past Budgeting Approach
Prior to implementation of the best practice approach to budgeting, ABC Healthcare’s budgeting process was segmented and extremely complicated. “Because ABC Healthcare included multiple hospitals and other types of organizations, the finance team had to work with numerous different general ledger systems, accounting structures, and budgeting processes,” notes the director of budget and decision support, who managed implementation of the strategic budgeting process.

Under the past budgeting approach, the finance staff provided the 210 department directors with a series of volume worksheets, revenue worksheets, FTE worksheets, and operating expense worksheets. Each step involved a 2- to 3-week time frame. The process was completely paper-based and required department managers to make manual mathematical calculations. After the managers submitted their worksheets, the finance staff had to key in relevant data. “This was time consuming and perhaps more importantly, because of the segmented nature of the data, the finance staff had to spend much more time entering data and reviewing the data for keying errors rather than analyzing the results. ‘Big picture’ analysis of the completed budget suffered,” says the budget director.

Implementing a Best Practice Approach
ABC Healthcare implemented strategic budgeting in fiscal year 1999. A new organizationwide decision support system and best practice approach was implemented. Spreadsheet-based budgeting software connected to a database enabled the organization to move to a completely electronic budgeting system. Department managers received intensive training in use of the new budgeting tool, which was loaded onto their personal computers. Group sessions, that provided hands-on education about software functions and the new budget templates, were followed up with one-on-one sessions with the finance staff. “Spreadsheet-astute department managers started serving as champions with their peers, making it easier to ensure rapid organizationwide integration of the new tool,” says the budget director.

From Strategic Plan to Financial Targets
The best practice strategic budgeting approach engaged ABC Healthcare’s leaders and operations staff in making the budget process an integral part of the financial management cycle. Working with a July 1 through June 30 fiscal calendar, senior leaders completed strategic plans by December 1 of each year. By this date, senior leaders also developed or fine-tuned a 3-year financial plan that identified financial performance targets for the next annual budget within the context of ABC
Healthcare's long-term strategic financial requirements. The senior leadership team created overall volume projections for the coming fiscal year, focusing on global statistical data, such as total patient days, discharges, length of stay, outpatient visits, physician clinic visits, and other items. The financial services department developed relationships tying these data to each department's primary statistic, as described earlier in this paper.

Review of Financial Targets

During a Budget Environmental Assessment meeting, department managers reviewed the strategic plan assumptions to validate the operational practicality of the plan goals. “In my estimation, this was the high point of the budget process, because it gave managers a look at the overall whole and the opportunity for input into the assumptions and the data that drove the initial volume projections,” notes the budget director. The group discussed on a department-by-department basis what might help achieve the strategic plan or prevent the plan's success. “The synergy created in that room was priceless—it put everyone on the same page and enabled all managers to clearly define the inter-department impacts of defined strategic initiatives.”

For example, when the director of oncology mentioned that a new oncology practice would be moving into an ABC Healthcare clinic and that he expected patient volume to increase by X%, the pharmacy director stated that she would need to increase her budget for chemotherapy agents. The laboratory manager also noted volume changes that would need to be made to his budget. “The old budgeting process, characterized by managers ‘doing their own thing,’ was replaced by an interactive, integrated process,” comments the budget director.

Following this meeting, the budget director met with senior leaders to summarize information provided by the department managers. Findings included the following:

- Length of stay (LOS), which had been decreasing steadily in one hospital due largely to a new surgical procedure performed in its major orthopedics unit, was starting to level off. Thus, the initial LOS forecasts, which drove patient day forecasts, needed to be adjusted upward for this facility. In addition, the finance staff recognized that LOS forecasts could more accurately be made by service line rather than by facility as a whole.

- Additional capacity was available at one facility because certain types of cases were shifting from inpatient to outpatient treatment. Thus, admissions forecasts could be bumped up due to the facility's ability to handle more admissions.

Senior leaders then modified volume projections, as needed, and closed the feedback loop by providing department managers with final financial targets.

Review of First-pass Budget

Next, in the first week of February, every department manager received an electronically distributed budget. Standardized budget templates were used to display unique entity structure and data. Color coding identified areas requiring input by the department manager. Global assumptions were built into the templates.

For example, the manager of the surgery department received a report that tied global assumptions about the targeted increase in overall admissions to the department’s two key statistics—inpatient surgical cases and outpatient surgical cases. Hence, the department manager’s volume budget was already completed and he had only to validate the data.

Managers loved the electronic files because most of the math was done for them.
“Managers loved the electronic files because most of the math was done for them. They just needed to review the results after inputting a few additional values,” says the budget director. When forecasting salary dollars, for example, department managers provided FTE information only, focusing solely on the number of people required to meet the projected volume level. The finance staff used budgeting software formulas to convert the FTEs to the appropriate hours and dollar data. The finance staff forecasted supply costs based on a variable cost basis plus an inflation factor. As volume changed, supply costs would go up or down appropriately. Department managers were able to adjust the inflationary increase if they knew price increases were going to exceed the inflation factor. For example, knowing that the nationwide industry average for pharmaceutical price increases was 5% to 13%, the finance staff used 8% as the inflationary increase. The pharmacy director could adjust this, as needed, and enter a comment about the basis for the adjustment in an appropriate narrative section for this item.

The new process also provided an opportunity for managers to raise any key concerns at this early budget development stage. “Knowing that the goal was to get the budget done in one and a half passes, everyone worked hard to get the numbers right during the first pass. The big-ticket items were on the table, discussed, and agreed upon early on,” notes the budget director. This eliminated the need for the repeated back-and-forth passes so prevalent with a typical budgeting approach.

**Budget Finalization**

The financial services department finalized the budgets in March, focusing only on those issues that popped up on the radar screen. “FTE creep” was one such issue. This occurred because department managers were budgeting for FTEs based on head count rather than actual staffing needs. For example, if five people were currently on board in a specific department, the manager would override the 4.2 FTE count based upon year-to-date actual data and insert 5 FTE. To reconcile this problem, the finance staff talked with department managers about the realism of being at 100% staffing all year. “Ninety-nine percent of the managers realized that 100% staffing would not be achieved throughout the year and backed off the higher FTE numbers,” says the budget director. These managers, and those with flat or declining cost per unit of service or FTEs, were finished with the budgeting process—and it was only March. Budgets were compared to financial plan targets and differences were reconciled.

A close look at a payroll summary for the surgery department indicates the level of customized detail available within the budget database (Figure 3). The approach used in this monthly responsibility report involves tracking trends rather than the usual comparison of year-to-date and actual data. The display of biweekly payroll information allows the manager to more effectively review such issues as transfers between departments and time code keying. “Because salary costs account for such a high percentage of the total organizational costs, close analysis of clean payroll data is critical,” asserts the budget director.
Ongoing Management
ABC Healthcare’s budget is used by managers in the daily management of operations. Each month, department managers receive electronically distributed responsibility reports the day after the month-end close. Figure 4 provides one page of the monthly department budget variance report for the surgery department. Year to date results are used to update current year and long-term financial plan projections.

Lessons Learned
Within a one-year time frame, ABC Healthcare successfully implemented the numerous steps of a best practice budgeting process. The organization effectively rolled the financial plan down through the organization, learning the following lessons in the process:

- **Budgeting must be integrated into the whole of the financial management cycle.** Without this inter-connectedness, ABC Healthcare would not have been able to operationalize its strategic and financial objectives.
- **Department managers must be informed of strategic financial targets and buy into such targets.** Best practice budgeting at ABC Healthcare transferred responsibility for the strategic plan’s success down to the department manager level.

Managers no longer received simple budget input sheets with a request to input their wish lists. Instead, through the Budget Environmental Assessment, managers were responsible for reviewing a budget that met defined targets of organizational performance for new and ongoing strategic initiatives, and raising issues about why the given budget might not work. Managers identified exceptions or needed changes to an original budget, and defined alternatives that might exist to counteract those changes in order to keep the budget balanced.

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**SURGERY DEPARTMENT PAYROLL SUMMARY**

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<th>Department Payroll Summary-By Job Code</th>
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<th>FY02 YTD-Actual Dollars</th>
<th>FY02 YTD-Budget Dollars</th>
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**Grand Total**

| Total GL Code - 7030 | 62,917 | 59,206 | 58,396 | 235,816 | 247,174 |

**Figure 3**

Source: Kaufman Hall & Associates.
Budget reports must be user friendly. Department budgets and responsibility reports need to be designed for ease of understanding and use. ABC Healthcare’s responsibility reports evolved from basic reports to very robust analytic tools that department managers could use on an ongoing basis. Re-work was not necessary to create new reports because a properly designed tool could meet all of the varied reporting needs.

ABC Healthcare’s budget director concludes that while all department managers may not have agreed with her motto, “Budgeting is fun,” best practice budgeting was not complex, cumbersome, or time consuming for departmental managers. Managers admitted that the process was “not bad”—a major victory for any organization!

**SURGERY DEPARTMENT MONTHLY BUDGET VARIANCE REPORT**

<table>
<thead>
<tr>
<th>Account Nu</th>
<th>Account Description</th>
<th>Aug-01 Actual</th>
<th>Aug-01 Per Unit</th>
<th>Aug-01 Budget</th>
<th>Budget Per Unit</th>
<th>Budget Variance</th>
<th>Aug-00 Actual</th>
<th>2001-2002 Annual Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 IP Surgical Cases</td>
<td>534</td>
<td>576</td>
<td>(42)</td>
<td>613</td>
<td>3,480</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 OP Surgical Cases</td>
<td>670</td>
<td>585</td>
<td>85</td>
<td>541</td>
<td>3,194</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Statistic</td>
<td>1,204</td>
<td>1,161</td>
<td>43</td>
<td>1,154</td>
<td>6,674</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3200 IP Ancillary Services</td>
<td>4,966,070</td>
<td>4,511,549</td>
<td>454,521</td>
<td>4,113,090</td>
<td>27,276,595</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Inpatient Revenue</td>
<td>4,966,070</td>
<td>9,299.76</td>
<td>4,511,549</td>
<td>7,832.55</td>
<td>27,276,595</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4200 OP Ancillary Services</td>
<td>1,698,865</td>
<td>1,679,589</td>
<td>19,277</td>
<td>1,381,008</td>
<td>9,174,368</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Outpatient Revenue</td>
<td>1,698,865</td>
<td>2,535.62</td>
<td>1,679,589</td>
<td>2,871.09</td>
<td>9,174,368</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Total Patient Revenue</td>
<td>6,664,935</td>
<td>5,535.66</td>
<td>6,191,138</td>
<td>5,332.59</td>
<td>36,450,963</td>
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</tr>
</tbody>
</table>

**Expenses***

<table>
<thead>
<tr>
<th>Account Nu</th>
<th>Account Description</th>
<th>Aug-01 Actual</th>
<th>Aug-01 Per Unit</th>
<th>Aug-01 Budget</th>
<th>Budget Per Unit</th>
<th>Budget Variance</th>
<th>Aug-00 Actual</th>
<th>2001-2002 Annual Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>7010 S&amp;W-Management &amp; Exec Lead</td>
<td>19,724</td>
<td>16.38</td>
<td>12,857</td>
<td>11.07</td>
<td>(6,867)</td>
<td>22,683</td>
<td>77,510</td>
<td></td>
</tr>
<tr>
<td>7020 S&amp;W-General/Medical Professional</td>
<td>18,017</td>
<td>14.96</td>
<td>(5,541)</td>
<td>(4.77)</td>
<td>(23,557)</td>
<td>198,799</td>
<td>(31,808)</td>
<td></td>
</tr>
<tr>
<td>7030 S&amp;W-Registered Nurse</td>
<td>261,937</td>
<td>217.56</td>
<td>278,632</td>
<td>239.99</td>
<td>16,695</td>
<td>241,652</td>
<td>1,635,356</td>
<td></td>
</tr>
<tr>
<td>7040 S&amp;W-Clinical Assistants &amp; Aides</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>30,656</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>7050 S&amp;W-Gen’l/Clinical Tech Specialist</td>
<td>176,029</td>
<td>146.20</td>
<td>210,466</td>
<td>181.28</td>
<td>34,437</td>
<td>---</td>
<td>1,248,832</td>
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</tr>
<tr>
<td>7070 S&amp;W-Service Workers</td>
<td>33,885</td>
<td>28.14</td>
<td>34,754</td>
<td>29.93</td>
<td>869</td>
<td>---</td>
<td>208,940</td>
<td></td>
</tr>
<tr>
<td>7080 S&amp;W-Office &amp; Clerical</td>
<td>22,228</td>
<td>18.46</td>
<td>22,326</td>
<td>19.23</td>
<td>98</td>
<td>30,411</td>
<td>134,079</td>
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</tr>
<tr>
<td>Total Salaries</td>
<td>531,820</td>
<td>441.71</td>
<td>553,494</td>
<td>459.71</td>
<td>21,675</td>
<td>524,201</td>
<td>3,272,909</td>
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</tr>
<tr>
<td>7326 Resident &amp; Intern Fees</td>
<td>36,671</td>
<td>30.46</td>
<td>31,372</td>
<td>27.02</td>
<td>(5,399)</td>
<td>---</td>
<td>188,232</td>
<td></td>
</tr>
<tr>
<td>Total Professional Fees-Medical</td>
<td>36,671</td>
<td>30.46</td>
<td>31,372</td>
<td>27.02</td>
<td>(5,399)</td>
<td>---</td>
<td>188,232</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4
Source: Kaufman Hall & Associates.
Founded in 1985, Kaufman Hall & Associates is counted among the country’s most respected independent financial and capital consultants, working with healthcare organizations of all types and sizes. Kaufman Hall provides financial advisory services to debt transactions, prepares and implements financial and capital plans, designs comprehensive capital allocation processes, and assists in the evaluation, structuring and negotiation of merger, acquisition and divestiture transactions. In addition, Kaufman Hall developed and markets the ENUFF Advisor® Suite of financial management software products. Kaufman Hall serves its clients from offices in Chicago, Los Angeles, San Francisco, and Atlanta.