5 APPROACHES TO EFFECTIVE BUDGETING AND FORECASTING IN HEALTHCARE
INTRODUCTION

Healthcare Finance in the Post-Reform Era

Much has been written about the impact that healthcare industry reform is having on hospitals and health systems. With the challenge of reduced reimbursements looming, Finance teams understand that realizing the bottom-line benefits of cost containment and process improvement initiatives is becoming a business imperative. However, as organizations critically evaluate their financial management capabilities, many realize they have ineffective approaches designed around antiquated tools that aren’t up to the task.

Sound familiar? Does the notion of redesigning your planning processes sound daunting? The five approaches in this ebook represent a framework that can improve the efficiency and accuracy of your budgeting and forecasting processes.
Disconnected Planning Processes

As modeling uncertainty becomes more common, it is increasingly important to intelligently and efficiently link multi-year, monthly forecasting and annual budgeting models. However, organizations that rely on spreadsheet-based, stand-alone financial models struggle to modify assumptions and evaluate the impact of changes across plans -- at an entity and operational (by dept.) level -- because it is too resource-intensive and error-prone.

Fragmented Data Across Financial and Patient-Centric Sources

Finance is being asked to produce more sophisticated financial models. Data to support decisions are increasingly being sourced from data not contained in the General Ledger to support volume, workload, revenue, and labor planning. Most organizations lack a common platform to effectively manage this data, adding increased complexity and inefficiencies to the planning process.
Best practices are often advertised as "silver bullets." As Finance teams look to re-engineer inefficient and ineffective budgeting and planning methodologies and tools, they realize that one approach can’t be right for every hospital or healthcare provider.

In reality, a "best practice" planning methodology can’t be hard-wired and applied to every organization. An optimal process is often a function of an organization's culture or even the competitiveness of its market. This publication describes five effective budgeting and forecasting approaches used by successful healthcare provider organizations.
1. Align rolling forecasts, multi-year plans, and detailed budgets

2. Embrace statistically-driven approaches to enable efficient "what-if" modeling

3. Incorporate Service Line Analytics to refine projections

4. Provide cross-departmental initiative-based modeling

5. Promote feedback loop with management and executives via reporting

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Planning across multiple time horizons has become increasingly important due to industry reform. Historical run-rates are no longer the best indicator of future performance, driving the need for more dynamic forecasting and "what-if" modeling. Aligning plans, models, and budgets is imperative.

- **Rolling Forecasts** – Actual and monthly projections for 6-12 quarters provide a trended view of performance, typically represented at an entity level. The model helps assess current realities that will influence longer-range (multi-year) projections, as well as detailed operational plans.

- **Multi-Year Plans** – Multi-year planning enables organizations to understand not only the impact external market business drivers will have on bottom-line results, but also internal initiatives. Baseline assumptions (current outlook 3-5 years), combined with independently modeled initiatives projecting the impact of targeted growth strategies or cost containment efforts, can be used to evaluate different "scenarios."

- **Detailed Budgets** – When done effectively, budgeting gives each Manager visibility into how baseline projections and new initiatives are impacting his/her financial plan. Refinements are made collaboratively with each department, resulting in a plan that promotes ownership of the numbers.

All of these plans must be kept in sync using the same assumptions to provide a holistic short- and long-term outlook that supports informed decisions.
Align rolling forecasts, multi-year plans, and detailed budgets

**Rolling Forecast**
Evaluate and trend actual performance against defined plans, project outcomes given current situation. (Outlook – 6-12 quarters)

**Multi-Year Planning**
Model scenarios to assess the impact of market and volume drivers on bottom-line results. (Outlook – 3-5 years)

**Detailed Budgeting**
Translate defined strategies into operational budgets and plans. (Outlook – 12 months)
When organizations are leveraging stand-alone spreadsheet models, or using "bottoms-up" approaches, the models are not easily adjusted to reflect impacts to varying volume and rate assumptions.

Establishing the proper statistical relationships to adjust hospital drivers to "flex" volume, workload, revenue, and departmental plans is essential to efficient planning in healthcare. Assumptions related to global volumes, reimbursement rates, inflation factors, labor rates, and efficiency targets should cascade down to "flex" revenue and expense plans.

When evolving to a driver-based model, the following are key design considerations related to data flow and "points of control" in the model:

- Identify with each department the statistic that represents its workload intensity (Acuity Adjusted Patient Days, Weighted RVUs)
- Establish the relationship each Department Workload stat has to Global Drivers (Acute Admissions)
- Use intuitive calculation methods that enable managers to clearly see impact of volume and rate changes on variable dollars/hours
- In Nursing floors, accommodate differences in staffing various shifts so that changes in volume adjust daily census and flex hours using staffing grids
Embrace statistically-driven approaches to enable efficient "what-if" modeling

4 Key Improvement Initiatives:

**Streamline Processes**
Consolidate data from financial, payroll, and patient-centric sources

**Improve Accuracy**
A statistically-driven approach enables the efficient flow through of volume/rate changes

**Promote Buy-in**
Efficiently consolidate results of baseline projections and add-on initiatives

**Drive Accountability**
Effective management reporting can show volume adjusted plans, and identify controllable expenses
More and more organizations are looking to incorporate patient-centric data into their planning models to drive more accurate volume and workload projections. Resulting plans more accurately reflect and offer transparency to the impact a service line’s growth would have on department budgets and net revenue.

**Why incorporate Service Line Analytics into your planning model?**

- Consistent use of service line volume, cost, and profit measures across multi-year plans, forecasts, and budgeting models aligns key functions such as market planning, physician recruitment, and revenue forecasting
- Historical or modeled department utilization profiles by service line can be developed to project workload statistics
- Such analytics integrate the volume planning with revenue planning so future reimbursement rates can be modeled more precisely by clinical population
- With volume and revenue plans based on service line categories, variances to the overall volume and mix of cases are better explained in plan-to-actual reporting
Incorporate Service Line Analytics to refine projections

Volume Projections
- IP Orthopedics
- Total Hips
- Knee Replacement
- IP Cardiac
- Heart Failure
- Knees

Adjustments for volume and growth made at Service Line Level

Payer Profile
- Commercial
- Medicare

Derives the impact of each additional case

Utilization Profile
- 4500 - Radiology
- 4800 - Laboratory

For each "node," payer and department workload analytics are derived

Revenue Drivers
(Payer Volumes, Historical Rates)
- Commercial
- IP Orthopedics
- IP Cardiac

Impact of volume projections flows through revenue and workload plans

CONSOLIDATED RESULTS

DEPARTMENTAL BUDGETS

NET REVENUE PLAN

Budgets are then finalized with rate and bottoms-up adjustments
For most organizations, the applications and frameworks in place to forecast hospital budgets were structured at a Department level (i.e., Lab, Radiology), or in the case of multi-year plans, projections are performed at the entity level.

How are new planning realities influencing planning models?

**Baseline and Initiatives-Based Planning** – Budgets and multi-year plans are comprised of a baseline set of assumptions, based upon business as usual given known market and industry-related variables. More than one baseline set of assumptions might be needed (i.e., conservative, aggressive). Additionally, initiatives modeled separately allow organizations to evaluate how directed efforts related to growth, cost containment, or process improvement will (or should) impact functional departments.

**What-if Modeling** – To evaluate the best course of action, Finance teams need to evaluate which combination of baseline assumptions and initiatives offer the best "go-forward" plan. The ability to "turn on and off" the impact of these projections in consolidated reporting becomes essential.
Provide cross-departmental initiative-based modeling

**Base Case**
Given current trends, what is our financial outlook 3-10 years?

**Initiatives**
What is the impact of various growth and cost containment initiatives?

**Scenarios**
To evaluate go-forward plans, what is the financial impact of different strategies?

**DRIVERS MODEL:**
- Volume and Service Line Mix
- Payer Mix and Net Revenue
- Labor and Cost Rates

**EXAMPLES INCLUDE:**
- Re-Design ER to Improve Patient Flow Through
- Expand Cardiac Cath Lab
- Expend OP Urgent Care

**ANALYSIS CONTAINS:**
- Income Statement
- Balance Sheet
- Cash Flow
- Key Ratios
All too often, reporting is a one-direction dump of statistics or numbers. Reporting is more effective when outlier variances have an explanation or action plan associated with them. This improved feedback loop promotes greater accountability across management levels. Reports for each level of the organization provide visibility as well as promote accountability.

Effective financial performance reporting should have the following characteristics:

**Be Role-Based** – Dashboards provide Executives with effective high-level indicators of performance, and more detailed information for managers.

**Incorporate Alerts and Notifications** – Notifications related to report readiness or outlier variances should proactively notify users by pushing notifications to inboxes or phones.

**Improve the Feedback Loop** – Ideally, explanations and commentary are part of the reporting process. Managers must understand “what” outliers exist and then offer commentary around “why.”
5 Promote feedback loop with management and executives via reporting
Your organization now can align business realities and financial plans through one, unified performance management platform. Designed for healthcare organizations, Kaufman Hall delivers sophisticated planning, reporting, and decision support functions in a single solution.