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# Preparing a Budget for the Small Hospital

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## Preparing a Budget for the Small Hospital

Prepared for

UHON 499

Honors Thesis

bу

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Preparing a Budget for the Small Hospital

#### Executive Summary

Team work should be utilized in developing an annual financial budget. The projection of the financial outlook for each department can usually be made by department heads since they are responsible for the daily operation of their unit. Their involvement normally produces less variances from the budget. These forecasts, after input and careful scrutiny by the administration, can provide important information in developing an overall financial budget for the hospital.

A budget is a formal written statement of a hospital's plan for the future. The financial budget is a management control tool normally covering a one year period. The essentials of budgeting are to set specific goals for future operations and to have a periodic comparison of actual results with the financial goals established. Many types of budgets can be used, but three which are important to any hospital are the operating budget, capital budget and the cash budget.

#### ACKNOWLEDGEMENT

I want to thank Mr. Jerry Hickam, a health care professional, for teaching me his methods in preparing a budget. He has taught me that excellent results can indeed be achieved by the prudent and consistent monitoring of the budget.

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Preparing a Budget for the Small Hospital
Introduction

The ability of small hospitals to survive largely depends on external factors such as state and federal healthcare legislation, and internal factors, such as the preparation of a successful financial budget. The focus of this report is the preparation of the small hospital financial budget.

Developing a financial budget is a process that should use team work to plan and implement if it is to be effective. The budget sets perimeters for management to follow throughout the year, allowing the managers to report variances while providing guidance so variances are maintained at a minimum and adjusted when possible. By using all department managers in the planning process of the budget, the administrator is able to develop effective strategies because all departments are invested in the goals. This eliminates many problems associated with the budget and identifies areas that need improvement.

As a result of competition, declining margins, and other economic pressures, administrators are taking several steps to control costs and increase revenues.

The budget process is one of the best tools known to do just that. The objectives of a budget are:

- \*to provide written terms of the hospital goals
- \*to provide a basis for the evaluation of financial performance according to the plans
- \*To provide a tool to control costs
- \*To create cost awareness hospital wide

#### Statistical Budget

The first step in preparing an operating budget is to prepare the statistical budget. The objective is to provide a measure of activity in each department for the upcoming budget period. Diagnostic departments measure how many procedures will be provided for the upcoming year, while nursing estimates the number of patient days anticipated. Knowlede of the past performance of a facility is useful in the forecasting. The last frive years is an appropriate amount of history to keep on file. This enables management to plan for future operations. Comparisons of past performance with current operations may indicate favorable and unfavorable trends. For example, it is very helpful to review the past history of full time equivelents (FTEs) for each department in a hospital. This enables management

to set goals to lower overtime, sick time, etc. It enables management to maintain FTEs to within the budget.

Departments should be requested to estimate the volume of their activity, but the financial managers should have the final control. This is important because department managers may tend to overstate volume and this could be devastating when the budget is not met. However, the departments should be involved because top management tends to be too conservative.

Each department has their own set of variables to examine prior to forecasting. Kay variables to examine are patient days and outpatient visits. Managers should look at the census per month over the past few years to project the number of patient days expected in the future. Equal visits over twelve months cannot be assumed. Seasonal, weekly, and daily patterns should be reviewed. For example, Christmas is usually a slow time of the year, so you would probably budget fewer patient days in December than in maybe June. Other areas of concern may involve a physician planning to retire, which would affect admissions and patient volume.

#### Expense Budget

This is the second step in preparing an operating budget. After the statistical budget is prepared, each department can then prepare their expense budget. The expense budget is the amount of money each department expects to pay out. These expenses include salaries, supplies, and other various expenses. These are the dollars the departments must stay within.

#### \*Salaries

It is a good idea to give each department manager a worksheet with each of their employees listed with their anniversary date, present hourly pay, and number of hours scheduled to work. The department manager can then make corrections as necessary. They can also look at a pay scale and decide what increases the employee will get at their anniversary date. This is also a good time to budget for vacancies and make all corrections.

#### \*Supplies

Input from the department heads are necessary if there will be price increases from the vendors and what percentage the prices will increase. If expenses go up, the revenue budget should increase proportionately.

#### Revenue Budget

The revenue budget is a forecast of the income a hospital expects to receive for the budget period. "The not-for profit nature of the health care industry demands that revenue be related to budgeted expenses." (Cleverley, 1986, p.263).

The preparation of the revenue budget entails the projection of patient service revenues, other operating revenues and non-operating revenues. "Total patient service revenues are calculated by multiplying the expected service volume in each revenue center by the charge per unit of service." (Cirn & Gellatly, 1988, p. 101). You will need to decide what percentage of price increase will be needed to produce the "bottom line" you desire. a good idea to print what the results would be at each percentage to get a true picture. The percentage level decided upon needs to be enforced on all charges. example, if X-Ray's total ancillary charges for every procedure offered equals \$550,000 and you decide on a 10% charge increase, then the \$500,000 will have to increase to \$550,000. You can either increase each procedure by 10% or increase some and decrease others. Just be sure the bottom line is increased by 10%. This is important that

Other operating revenue projections should be considered. Examples are, dietary sales from lunches sold to employees and silver sales from old x-ray films.

Non-operating revenues would include contributions and interest from investments. Contributions are sometimes difficult to project while interest on investments are an important part of the non-operating revenues.

#### Operating Budget

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The operating budget is composed of the expense budget and revenue budget. It lists, for the upcoming fiscal year, anticipated income by source, and anticipated expenses by "natural classification," such as salaries, supplies, and utilities. Administration should always pursue a larger revenue budget than expense budget, therefore projecting a profit on the bottom line. The profit is used to finance the capital budget.

#### Capital Budget

The capital budget summarizes future plans for acquisitions of plant facilities and equipment. "The average U.S. hospital increases its' investment in net property by 9.3% per year." (BKD, 1990, p.1). "A hospital must determine how much of its' capital plan to devote to

renovations and expansion projects." (Bentivegna & Calwell, 1990, p. 44-50). Management also has to examine the hospital's operating performance and current financial status to see whether future financing is needed.

\*Identify your capital needs.

Each department should be given a capital budget worksheet and guidelines to list their capital budget items. A \$500 minimum dollar amount per item or \$1000 per group of items is reasonable. Otherwise you will clutter your fixed equipment appraisal report.

\*Regarding financial allocations, prioritize the equipment desired based upon need and money available for purchasing or leasing. List URGENT, ESSENTIAL, ECONOMICALLY DESIRABLE, and GENERALLY DESIRABLE.

\*Managing capital needs.

The equipment can be purchased only after approval of the budget, but not all at one time. For example, you could review the capital budget on a quarterly basis and compare cash flow statements to your capital budget. Only spend on a quarterly basis, so you have an even spending for purchases.

#### \*Example:

A facility has a \$200,000 capital budget: \$200,000 divided by 4 quarters = \$50,000 expenditures per quarter. If you need a piece of equipment that costs \$75,000 the purchase could be made, but during the next quarter, the total expenditures allowed would only be \$25,000.

#### Cash Budget

Without cash a hospital cannot survive. This is the primary reason for a cash budget. Because of the many changing reimbursement rates from Medicare, Medicaid, and Health Maintenance Organizations (HMOs), predicting cash flow requires a lot of thought and planning. Cash flow should be reviewed on a monthly basis to enable administration to foresee cash shortages and seek possible financing if necessary. The cash flow statements basically indicate the difference in the balance sheet accounts. The reader should focus on how the debt is being used. For example, if the hospital shows operating losses, working capital increases, and increases in capital expenditures, the funds will probably have been generated by long-term or short-term borrowing. The cash flow statement helps determine how debt is being used by the hospital.

Financial managers should make sure they do not spend too much time on deciding how to get cash rather than how to invest and manage what they have. Higher interest rates will also generate extra funds.

#### Financial Statements

Financial statements are a summary of financial results. The financial statements prepared at the end of each month are:

- \*Statement of revenues and expenses budgeted and actual 
  \*Balance sheet
- \*The statement of revenues and expenditures budgeted and actual, shows the revenue recognized during
  the period and the expenses incurred during the period.

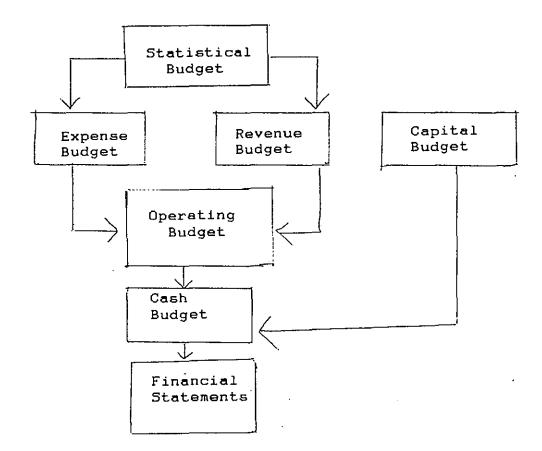
  Each revenue and expense should be compared to the projected
  budget. This report shows the results of the hospital
  operation by reflecting a profit or loss on the bottom
  line. This is also known as the Income statement.
- \*The balance sheet indicates the hospital's financial position. The assets, liabilities, and capital of the facility is reported. The equation is as follows: Assets = Liabilities + Capital. The assets are listed as current and non-current in the order of their liquidity. Current assets are expected to be consumed in one year and non-current over a longer time period. The liabilities are also listed as current and non-current. The capital section will be labeled fund balance in the case of a not-for profit organization.

#### Conclusion

The formulation of a realistic budget is a key to the efficient operation of any hospital, and is especially critical to the survival of the small hospital. efficiency results in a level of high quality care, which in return results in financial success for the hospital. Budgets help accomplish this because the budget process and financial statements identify problems, define areas for improvement, and concurrently allow administrators and supervisors to maintain and reinforce excellence. Recognition and reinforcement should be given to department employees for outstanding performance in providing quality service and in staying within their forecasted budget. Without a teamwork approach the administrator may find the guidelines will not be met because the departments are not invested in staying within their budget. Consequently, the administrator may be looking for another job. Planning and timely preparation are also key components. Do not wait until two weeks before a budget is due to prepare one. Minimally a couple of months are needed. As department heads gain budgeting experience, they should be motivated to make budgetary planning an ongoing function. This will reinforce the importance of their role in providing timely information to the administration and their subordinates.

The ultimate responsibility of forecasting a realistic budget rests with the hospital administration. Sound accounting practices, a knowledge of services provided by other area hospitals, and the impact of continually changing legislation regarding mandated services, are imperative factors in projecting a budget.

Preparing a Budget for the Small Hospital
Flow Chart



## HOSPITAL DEPARTMENTAL HISTORY SHEET

		DEPT	RADIOLOGY		DEPT #
DESCRIPTION	1988A	1989A	1990P	1991B	
SERVICE STATISTICS:		<u> </u>	# # # # # # # # # # # # # # # # # # #	=======================================	<b>=</b>
Inpatients	3450		3414		
Ultrasound Inpt	45	89			
CT Scans Inpt		70	155	170	
Outpatients	5350	5874	5694	5700	
Ultrasound Outpt	240	250			
CT Scans Outpt		88		190	
Mammography		154	273 	275 	<del>_</del>
TOTAL		· <del>-</del> ·	10158	<del>-</del>	_
RATIO INCR (DECR	ERR	7.45	4.06	2.38	
REVENUES:				= = = = = = = = =	=
Inpatients	185000	181501	241566	279100	
Nursing Home	6100				
Outpatients	276800	354025	404113	440400	
~~~~					_
TOTAL			651617		_
RATIO INCR (DECR	ERR	15.41	20.67	11.45	
PAID HOURS:	=======	=========			=
Regular	6839	7453	7524	12696	
Overtime	155			104	
Holiday	168				
Vacation Sick	270 208	335 214			
DICK		C14	104		-
TOTAL			8368		
RATIO INCR (DECR	ERR	8.82	0.65	52.96	
	3.67	4.00	4.29	6.15	
OPERATING EXPENSES:	<u></u>				•
HOSPITAL:					
Salaries			79991		
Fees Supolies	8347		3946 175130		
Supolles Equip Rental					
wew.periodic	C1.400	1.776	1 20 20	· 나르다하	
HOSPITAL TOTAL	1/1915	227938	278963	230817	

HOSPITAL

DEPT. RADIOLOGY

NO.

626

14

#### SALARY BUDGET WORKSHEET

=======	========	====	=======					-
EMPLOYEE		ATE RE	ADJUSTED DATE H.	NX SCH REVIEW	CURRENT HRLY R.	MONTHLY HRS.	DIFF. RATE	
========	========	====			========	=======		:==
SECRETARY	APR	18	1		6.12	164		
TECH	oct	12 8	5		7.25	4		
TECH	APR	10 8	4		7.25	164		
TECH ADE	FEB	2 7	5		7.01	164		
DIRECTOR	JUN	3 7	4		10.20	174		

\_

. :

DEPT. RADIOLOGY

VAC.

NO.

626

VAC. DIFF. O.T. AND STAND-BY BUDGET WORKSHEET \_\_\_\_\_\_\_

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ J. TITLE NO. PEO. NO. WKS. WK. RATE AN. COST O Ō O TOTAL Ō STAND BY NO.PEO. NO.WKS. WK.RATE AN.COST O Ō TOTAL 18000 ======== DIFF. BI-WK. HRHR. RATE BI-WK CSTAN. COST Ö  $\circ$ 0 O O TOTAL \_\_\_\_\_\_ O. T. HRS/WK NO.WKS. AN.HRS. T/H RATE AN.COST 1 52 52 12.09 629 O O Ŏ 629 TOTAL =======

16

HOSP1TAL

DEPT.

RADIOLOGY

NO.

626

SALARY SUMMARY BUDGET WORKSHEET

5========	2222222	=======	=======	=======		========		=======		==========		=======	=======
EMPLOYEE	JULY	AUG	SEPT	OCT	VOV	DEC	JAN	FEB	MARCH	APRIL	MAY	JUNE	TOTAL
SECRETARY	1010	1010	1010	1010	1010	1010	1010	1010	1010	1050	1050	1050	12241
TECH	30	30	30	32	32	32	32	32	32	32	32	32	376
TECH TECH ADE	1302 1159	1302 1210	1302 1210	1366 1210	1366 1210	1366 1210	15818 14168						
DIRECTOR	1917	1917	1917	1917	1917	1917	1917	1917	1917	1917	1917	2045	23137

5419.36 5419.36 5419.36 5421.12 5421.12 5421.12 5421.12 5471.96 5471.96 5575.28 5575.28 5702.30 65739.34 TOTAL

17

HOSPITAL

DEPT. RADIOLOGY

ND. 626

SALARY SUMMARY BUDGET WORKSHEET

		60t	/OL	// )CL			****						
DESCRIPTION	JULY	AUG	SEPT	OCT	NOV	DEC	JAN	FEB	MARCH	APRIL	. MAY	JUNE	TOTAL
=2257222257722	22333223522	=======================================	======================================	:= <b>===</b> ===		::::::::::::::::::::::::::::::::::::::		:::::::::::::		:#25a#2¥#3	:::::::::		
OTHER	5419.36	5419.36	5419.36	5421.12	5421.12	5421.12	5421.12	5471.96	5471.96	5575.28	5575.28	5702.30	65739.3
													0.0
CALL BACK VAC.	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	1500.00	
DIFF.	E0 00	E0 44	E0 00	E0 00	F0 44	F0 00	E0 60	E0 00	FO 00	ra aa	F0 44	#7 AA	0.0
0. T.	52.00	52.00	52.00	52,00	52.00	52.00	52.00	52.00	52.00	52.00	52.00	57.00	629.0
TOTALS	6971.36	6971.36	6971.36	6973.12	6973.12	6973.12	6973. 12	7023.96	7023.96	7127.28	7127.28	7259.30	84368.3

:

HOSPITAL

DEPT.

RADIOLOGY

NO. 626

SUPPLIES & EXPENSE AND TOTAL EXPENSE BUDGET WORKSHEET

ITEM NO 5 6 7 8 9 10 12 11 \_\_\_\_\_\_ DESCRIPTIACET # SEPT JULY AUG OCT NOV DEC JAN FEB MARCH APRII MAY JUNE TOTAL 626.80 7500.00 7500.00 7500.00 9145.00 9145.00 9145.00 9145.00 9145.00 9145.00 9145.00 9145.00 9145.00 9145.00 SCANS 7023.96 7023.96 7127.28 7127.28 7259.30 84368.34 SALARIES- 626.01 6971.36 6971.36 6971.36 6973.12 6973. 12 6973. 12 6973. 12 950.00 950.00 950.00 950.00 950.00 11400.00 NUCL MED 626.60 950.00 950.00 950.00 950.00 950.00 950.00 950.00 2500.00 2500.00 30000.00 FILM 626.50 2500.00 2500.00 2500.00 2500.00 2500.00 2500.00 2500.00 2500.00 2500.00 2500.00 MAMMOGRA 626.30 1333.00 1333.00 1333.00 1333.00 1333.00 1333.00 1333.00 1333.00 1333.00 1333.00 1337.00 16000.00 SPECIALIS 626, 10 300,00 300.00 300.00 300.00 300.00 300,00 300.00 300.00 300.00 300.00 300.00 300.00 3600.00 SUPPLIES 626.20 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 2250.00 TRAVEL # 626.40 100.00 100.00 100.00 100.00 100.00 100.00 100.00 100.00 100.00 100.00 100.00 100.00 1200.00

EQUIP LEA 626.70 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1658.00 1662.00 19900.00

TOTALS

23562, 36 23562, 36 23562, 36 25209, 12 25209, 12 25209, 12 25209, 12 25259, 96 25259, 96 25363, 28 25363, 28 25498, 30 298268, 3 

# HOSPITAL STATEMENT OF REVENUES AND EXPENSES PERIOD JULY 1, 1991 THRU JUNE 30, 1992 CONSOLIDATED (Umaudited)

	Projected Current Year	Budget	Increase Decrease	Ratio
General patient days	6,963	6, 963	0	0.00
Special care patient days	577	577	Û	0.00
Total	6, 726	6, 726		0.00
Nursing Home Patient Days		20, 940	0	
Operating revenues:				
Nursing, dietary and room services	2,498,865	2,613,345	114480	4.58
Ancillary inpatient services	3, 015, 478	3, 209, 818	194340	6.44
Ancillary outpatient services	2, 376, 223	2,622,024	245801	10.34
Clinical services	355, 951	214,500	-141451	-39.74
Gross patient revenues	8,246,517	8,659,687	413170	5.01
Less: Uncollectible accounts	184, 824	195,000	10176	5.51
Contractural differentials	2,376,118	2,668,200	292082	12.29
Clinical writeoffs	100, 996	77,200	-23798	-23.56
Total deductions from revenue	2,661,938	2,940,400	278462	10.46
Net patient service revenues	5,584,579	5,719,287	134708	2.41
Operating expenses:				
Nursing services	1,714,435	1,803,796	89361	5.21
Ancillary services	1,263,198	1,349,561	86363	6.84
General services	2,200,093	2,271,418	71325	3.24
Clinical services	278, 233			
Total expenses	5, 455, 959	5, 573, 944	117985	2.16
Total profit or loss	·	145, 343	16723	13.00
Other revenues and expenses:				
Contributions	439, 765	461,000		4.83
Other revenues	200, 236	199, 450	-786	-0.39
Depreciation expense	277,400	279,600	2200	0.79
Total other	,	380,850		5.03
Net profit or -loss	491,221	526, 193	34972	7.12

HOSPITAL THREE YEAR CAPITAL BUDGET FISCAL YEARS ENDING JUNE 30, 1991–1993

DEPARTMENT	1991	1992	1993
Nursing service medical/surgical	11,150	4,650	0
Special care unit	1,000	8,000	О
Emergency room	3,000	3,000	o
Nursing home	7,600	2,600	2,800
Operating room, recovery room, and anesthesia	39, 945	20,000	o
Central service	920	o	o
Laboratory	40,600	O	o
Radiology	395,000	30,000	20,000
Pharmacy	700	200	30,000
Respiratory	550	o	0
Physical therapy	5, 900	O	0
Medical records	14,300	0	o
Dietary	6,785	875	o
Operation of plant and maintenance	165, 877	7,400	22,800
Housekeeping and laundry	45,000	o	O
Business Office	780	200	500
Administration and Data Processing	3,180	1,000	1,000
Contingency		150,000	150,000
TOTAL	•	227,925	
SOURCE OF FUNDS: Depreciation expense Less: Principal payments Working capital Profits TOTAL	279,600 110,000 169,600 400,000	279,600 140,000 139,600 230,000	279,600 150,000 129,600 230,000
Court Collins	======	•	•

	1991	1990
Current assets:		
Cash and		
Investments	210,071	591,893
Patients accounts receivable-net		925, 238
Due from government agencies	7,176	
Inventories	124,509	129,582
Prepaid expenses	136, 296	166, 766
Other receivables	1,500	424
Total current assets	1,366,904	1,828,914
Depreciation funds	179, 394	126, 116
Estate funds	711,222	
Bond funds	480, 297	444,189
Bond costs-net	19,366	21,160
Property, plant and equipment-		
net of accumulated depreciation	3,574,312	3,550,865
TOTAL ASSETS	6,331,495	
	=======	
Current liabilities:		
Accounts payable	113,721	114,295
Accrued payroll taxes	50,460	• •
Accrued payroll	27 <b>,</b> 903	.99, 864
Accrued vacation	156,762	-
Current portion long-term debt	206,515	216,363
Other accruals	81,218	
Accrued interest payable	15,677	
Due to governmental agencies	50,265	41,755
Yotal current liabilities	702, 521	815,089
Long-term debt-met of current portion	2,021,948	2, 222, 727
Fund balance:		•
Beginning 3,480,492		
Fiscal year-to-date profit or 126,534		
Transfer to or from restricted funds	3,607,026	3,648,116
		·
TOTAL LIABILITIES AND FUND BALANCE	6,331,495	6,685,932 ======

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