

# **MONEY** **TO CARE**



Hospital Finance  
For Non-Financial Hospital Leaders

**SAMPLE**  
**BOOK EXCERPT**

**Denise Harrison Chamberlain**

Money to Care  
Hospital Finance For Non-Financial Hospital Leaders

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# Budgeting Other (Fixed) Operating Expenses

Almost done! One last piece to budgeting left. This may be the part of your budget that takes the most of your time, or the least, depending on your hospital. If you work at a very large hospital where things can literally get lost in rounding, then this part of your budget may be done from a very high level. If you work in a smaller hospital where every penny is counted everyday, then this may be the piece of your budget that you are entirely responsible for—and will require many hours of your time.

Let's start by first taking a step back and looking where we've been so far in this section of the book. **Exhibit 15** (*pages 98, 99*) is a sample 12-month budget. Look down the rows on the left side, and you will see the line items that typically show on a budget. Now, as you look at those rows, think about what we have already covered: Gross inpatient and outpatient revenues, revenue deductions, net revenues, salaries, benefits, contract labor, and supplies. Seems like there's a lot left though, huh? And you are probably tired of talking about budgets, aren't you? Relax, actually we are almost done talking about them because all of the remaining items have one thing in common that makes budgeting for them very simple and straightforward—they are *fixed* expenses.

Fixed expenses. What does that mean? Remember in **Chapter 8**, where we discussed variable vs. fixed labor? We talked about fixed labor as being labor that does not fluctuate when volume fluctuates, whereas variable labor should increase or decrease as hospital volumes increase or decrease. The same applies to other expenses as well, and the expenses that we have left to discuss are all *fixed*.

Ok, not totally. I've already said before in this book that nothing is completely fixed, and nothing is completely variable. And that within relevant ranges, *everything* is fixed. Well, what the remaining accounts have in common is that generally, they all have a fairly wide relevant range—much wider than labor or supplies. Large enough that it covers the range of whatever the volumes for the hospital are budgeted to be for the coming year. Maybe I can say this another way that will help clarify. Repairs are considered a fixed expense. That does not mean that repairs at a 100 bed hospital will be the same as repairs at

<b>EXHIBIT 15</b>													
J Lee Community Hospital													
FY2011 Budget													
Radiology													
	October	November	December	January	February	March	April	May	June	July	August	September	Total
<b>Revenues:</b>													
Gross Inpatient revenues	\$1,240,000	\$1,200,000	\$1,240,000	\$1,240,000	\$1,120,000	\$1,240,000	\$1,200,000	\$1,240,000	\$1,200,000	\$1,280,000	\$1,240,000	\$1,200,000	\$14,640,000
Gross Outpatient revenues	\$1,612,000	\$1,560,000	\$1,612,000	\$1,612,000	\$1,456,000	\$1,612,000	\$1,560,000	\$1,612,000	\$1,560,000	\$1,664,000	\$1,612,000	\$1,560,000	\$19,032,000
Total Gross Revenues	\$2,852,000	\$2,760,000	\$2,852,000	\$2,852,000	\$2,576,000	\$2,852,000	\$2,760,000	\$2,852,000	\$2,760,000	\$2,944,000	\$2,852,000	\$2,760,000	\$33,672,000
Revenue Deductions	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Net Revenues	\$2,852,000	\$2,760,000	\$2,852,000	\$2,852,000	\$2,576,000	\$2,852,000	\$2,760,000	\$2,852,000	\$2,760,000	\$2,944,000	\$2,852,000	\$2,760,000	\$33,672,000
<b>Expenses:</b>													
Hospital Salaries	\$199,640	\$193,200	\$199,640	\$199,640	\$185,730	\$205,629	\$198,996	\$205,629	\$198,996	\$212,262	\$205,629	\$198,996	\$2,403,988
Contract labor	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Benefits	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Supplies	\$19,821	\$19,182	\$19,821	\$19,821	\$17,903	\$19,821	\$19,182	\$19,821	\$19,182	\$20,461	\$19,821	\$19,182	\$234,020
Maintenance and Repairs	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$144,000
Outside Services	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$3,200	\$38,400
Rental Expense	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Depreciation	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Interest	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Property Taxes	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Insurance	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Other Expenses	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$18,000
Total Expenses	\$236,161	\$229,082	\$236,161	\$236,161	\$220,333	\$242,151	\$234,878	\$242,151	\$234,878	\$249,423	\$242,151	\$234,878	\$2,838,408
<b>Net Margin</b>	\$2,615,839	\$2,530,918	\$2,615,839	\$2,615,839	\$2,355,667	\$2,609,849	\$2,525,122	\$2,609,849	\$2,525,122	\$2,694,577	\$2,609,849	\$2,525,122	\$30,833,592

<b>EXHIBIT 15</b>													
J Lee Community Hospital													
FY2011 Budget													
Radiology													
	October	November	December	January	February	March	April	May	June	July	August	September	Total
Gross revenue per stat	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00	\$400.00
Inpatient stat	3,100	3,000	3,100	3,100	2,800	3,100	3,000	3,100	3,000	3,200	3,100	3,000	36,600
Outpatient Stat	4,030	3,900	4,030	4,030	3,640	4,030	3,900	4,030	3,900	4,160	4,030	3,900	47,580
Total Stat	7,130	6,900	7,130	7,130	6,440	7,130	6,900	7,130	6,900	7,360	7,130	6,900	84,180
Labor Cost per Stat	\$28.00	\$28.00	\$28.00	\$28.00	\$28.84	\$28.84	\$28.84	\$28.84	\$28.84	\$28.84	\$28.84	\$28.84	\$28.56
Supply Cost per Stat	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78	\$2.78
Worked MH/Stat	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
Paid MH/Stat	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16
OT%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Paid Hours	8,235	7,970	8,235	8,235	7,438	8,235	7,970	8,235	7,970	8,501	8,235	7,970	97,228
Hospital FTEs	46.62	46.62	46.62	46.62	46.62	46.62	46.62	46.62	46.62	48.12	46.62	46.62	46.74
Contract Labor FTEs	-	-	-	-	-	-	-	-	-	-	-	-	-
AHR hospital	\$24.24	\$24.24	\$24.24	\$24.24	\$24.97	\$24.97	\$24.97	\$24.97	\$24.97	\$24.97	\$24.97	\$24.97	\$24.73
AHR contract labor	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-

a 1,000 bed hospital. But within the hospital that YOU work in, the volume doesn't change enough over the course of the year (unless you have construction going on) to increase or decrease repair expense. So *within that volume range*, repairs will not be affected by movements in patient volumes. That makes them a fixed expense.

What all is included in fixed expenses? If you look at **Exhibit 15** (pages 98, 99), you will see the example line items I have reflected as fixed expense lines: Maintenance and Repairs, Outside services, Rentals, Depreciation, Interest, Property Taxes, Insurance, and Other Expenses. Please note that these are my own example. Every hospital will be different. The names may be different, and some items may not show up at all. If you work for an investor-owned hospital, depreciation will definitely not be included. My point is that, going back to the discussion in **Chapter 3** on the *General Ledger*, every hospital sets up its own accounts to fit its needs, and what makes sense to them. It is important that there be sound reasons behind how accounts are grouped for financial statement presentation, but within reason, they may do whatever they want. There is no "rule book" that defines the Chart of Accounts or governs how accounts are presented. So going back to the question of what is included in fixed expenses—working backwards, you could say that fixed expenses are the expenses remaining after labor (including salaries, benefits and contract labor), supplies and bad debt. They may consist of many line items, but remember, for most hospitals they will only add up to around 25% of total expenses.

Budgeting for fixed expenses is very straightforward for two reasons.

First, as we just said, although there may be many accounts, each individual account is probably relatively small, and since budgets are always meant to be estimates, if an individual fixed account that is small is budgeted incorrectly, it won't materially affect the accuracy of the overall budget.

Second, most of the accounts are either very simple to accurately budget, or virtually impossible. A maintenance contract on your MRI is very simple. You probably already have a contract, and you pay a fixed fee every month that covers 90% of the things that may go wrong. Or you have an annual license inspection that has a fixed fee and always comes up for renewal in August. Easy. Repairs, on the other hand, are completely unpredictable. You never know what will need repair or when. That makes budgeting little more than a guess based on historical experience.

Enough talk about "what" and "why" of fixed expenses. Let's dig into "how" to budget them.

There is really only one approach. What will vary from hospital to hospital is the level of detail that is compiled. These budgets may be prepared at the "Account level" or at the "Vendor level." Which approach is used will determine how much work you are required to do. Either way, this part of the budget may



well be the one where you have the most input, and/or are required to be the most involved. Why? Because these accounts are fixed, so by definition, most of them do not change with volume. For most of these accounts, the amount you spend, and when you spend it are both completely independent of anything else going on around the hospital.

For example, the timing and amount you pay to renew your license and accreditation in your Lab has nothing to do with how many patients you are seeing in the department. It is probably a one-time expense, once a year—or maybe even once every three years. Some “fixed” expenses do have a loose connection to hospital or department volumes. Equipment rentals are an example of that. If your hospital rents specialty mattresses for specific patients, then the volume of rentals actually depends upon how many of *those* patients the hospital sees in a given month. History may tell you that “on average” you see (hypothetically) 50 of those patients each month. But you may also know that during certain times of the year, the volume of those patients tends to be higher (regardless of whether overall hospital volume is higher or lower), and/or that when the hospital volumes goes up, these rentals tend to go up as well. You can see that because of the many unique issues with many of these accounts, they do not lend themselves to modeling or to an automated template to budget them. To budget them appropriately, you actually need to handle them manually. That’s where you come in as the best person to know the details for these accounts. Finance will help you of course!

Let’s start with the approach that will be very simple and not require much time from you—the “Account level” approach. The advantage to this approach is that it can be done relatively quickly. The disadvantage is that you may not end up with a very accurate budget, and if you use this approach and want a more accurate budget, it can be messy to get there because you will need to manually intervene and override the high-level approach.

Look at **Exhibit 16** (*page 102*). Down the left side, you will notice that this Exhibit looks very similar to **Exhibit 1** (*page 22*) from **Chapter 3** (although it shows different accounts). These are sample accounts for a few fixed expense items that you may be budgeting for. Don’t worry if your hospital, or your department would use different accounts. The concepts will be the same.

Look across the columns at the top. As always, I have numbered them, and the row below that shows the formulas for each column. Let’s walk through this one step at a time together.

1. ***YTD Actual***: this column shows the actual year to date expenses that have been incurred. This data will be given to you.
2. ***Prorated portion of column 1***: Columns 2 and 3 show two different approaches that can be taken to estimate what the expense will be during the remaining three months of the year in order to get to a 12-month

<b>EXHIBIT 16</b>										
	Column #	1	2	3	4	5	6	7	8	9
	Formula	Input by Finance	(Col 1)/9 x 3	Input by Finance	Input Choice: col 2 or col 3	Col 1 + either col 2 or col 3	Input Inflation or Other Change	col 5 + col 6	col 7 / 12	Input Notes
		YTD Actual through 9 months	Prorated Portion of Column 1	Budget for 3 remaining months		12 Month Projected Amount		12 month Budget Amount	Assumed Budget per month	
6000.00	Maintenance & Repairs									
	Maintenance Contracts									
	6010.10 Bio-Med Equipment	\$900,000	\$500,000	\$250,000	2	\$1,200,000	\$-	\$1,200,000	\$100,000	
	6010.20 IT Hardware	\$2,000,000	\$666,667	\$1,000,000	2	\$2,666,667	\$300,000	\$2,966,667	\$247,222	
	6010.30 IT Software	\$4,500,000	\$1,500,000	\$1,500,000	2	\$6,000,000	\$1,000,000	\$7,000,000	\$583,333	
	Repairs									
	6020.10 Parts	\$1,000,000	\$333,333	\$120,000	2	\$1,333,333	\$26,667	\$1,360,000	\$113,333	
	6020.20 Labor	\$1,350,000	\$450,000	\$200,000	2	\$1,800,000	\$36,000	\$1,836,000	\$153,000	
	Outside Services									
7000.00	Clinical Services									
	7020.10 Reference Lab	\$1,800,000	\$600,000	\$300,000	2	\$2,400,000	\$120,000	\$2,520,000	\$210,000	
	7020.20 Imaging	\$-	\$-	\$200,000	2	\$-	\$-	\$-	\$-	
	License and Inspection									
	7030.10 JCAHO	\$270,000	\$90,000	\$90,000	2	\$360,000		\$360,000	\$30,000	
	7030.20 CAP	\$50,000	\$16,667	\$-	3	\$50,000	\$5,000	\$55,000	\$4,583	All \$55k in November
	7030.30 State License Fees	\$-	\$-	\$75,000	3	\$75,000	\$10,000	\$85,000	\$7,083	All \$85k in March

total projected expense. The amount shown in column 2 is based on a very simple formula: column 1 / 9 x 3. Since column 1 reflects nine months of data, dividing by 9 gives an average expense per month. Since there are three months remaining, the number is multiplied by 3 to get a projected total remaining expense for the remaining 3 months of the year. This approach can yield an inaccurate 12-month projection if you have expenses that do not occur ratably throughout the year. Look at the 7030 accounts (License and Inspections). These expenses frequently are a one-time expense during the year. Perhaps you have a once-a-year contract renewal fee that occurs in the last month of the year. Account 7030.30 reflects this scenario. Since it has not happened in the first nine months, using this approach, it will not be included in the projected remainder. Which means it would not be included in next year's budget. This is a very common mistake in budgeting of fixed expenses.

3. ***The remaining budget:*** This column reflects the second alternative for projecting remaining expenses for the year. If there are three months left, this column would be populated with the budget for those months. Following this approach is designed to avoid the problem discussed in 2. above, where you have a once-a-year expense that hasn't happened yet (but hopefully you budgeted it to happen later, so using this approach, the expense *will* populate in this column). Again, account 7030.30 is an example where this is a better approach. So is account 7030.20. In that case, the expense has happened, so no further expense needs to be added to the 12-month projection. But this approach can also lead to it's own problems. If something significant has changed, your monthly expenses for some of these accounts may be dramatically different than the budget that was prepared a year ago, so populating the projected remainder with the budget may not be even close to what you think will actually happen. Accounts 6010.10 and 6010.20 are two examples where using the budget for the remainder of the year yields a significantly different number than using a prorated portion of column 1. In the case of account 6010.10, the actual monthly average is running *more* than the remaining budget (\$300,000 vs \$250,000), whereas account 6010.20 has the opposite situation. The prorated portion of column 1 is less than the remaining budget (\$666,667 vs \$1,000,000).
4. ***Choice:*** column 2 or column 3 - This column would be populated by you. Here, you would indicate whether the amount shown in column 2 is a better approximation of what you expect to happen during the remaining 3 months, or column 3 is better.
5. ***12-month Projected Amount:*** This column is a formula. It adds together column 1 (the actual expense for the first nine months of the year) plus whichever column 2 or 3 you recommended as the best choice for projecting the remainder. The sum of the 2 numbers yields a 12-month

projection for the year. This amount then becomes the baseline, or starting point, for budgeting next year.

6. ***Inflation or other change:*** this column should be populated by you, based on your experience and knowledge. There is no science to this column. I've shown a few example scenarios using the different accounts:
  - a. Account 6010.10—I show no change. Perhaps you have a multi-year contract with an outside company that provides for a fixed monthly fee and there is no inflation/fee increase clause. So you know this amount will not increase.
  - b. Account 6010.20—I show a large change. Perhaps you bought some new equipment that will need a new maintenance contract next year.
  - c. Account 6010.30—I show a large change. Perhaps you have a go-live on some new software between now and year end, so new license fees will be due next year.
  - d. Accounts 6020.10 and 6020.20—I added 2% inflation.
  - e. Account 7020.10—I show a 5% increase. Even though this is considered a Fixed Expense, in fact, it probably moves with volume. In my scenario, if hospital volume is budgeted to increase 5%, you would want to probably increase this account by the same amount. Also, you may want to add an inflation factor to this account, unless you have a contract.
  - f. Accounts 7030.20 and 7030.30—I show large increases. Perhaps you have received a letter notifying you of these increases.
7. ***12-Month Budget Amount:*** This column is simply a formula adding columns 5 +6 together.
8. ***Assumed budget per month:*** unless it is manually changed, most hospitals budget fixed expenses ratably over the year, by computing the budget for the entire year, then budgeting 1/12th of it each month. That is what this column shows.
9. ***Input:*** this column is where you might indicate that the budget should NOT be simply spread over 12 months, but instead put in a particular month. I demonstrate this in accounts 7030.20 and 7030.30.

The other approach to budgeting fixed expenses follows the same concepts I've shown in **Exhibit 16** (page 102), except that instead of just walking through the process for each G/L account, you do it for each *vendor within each account*. As you can imagine, this process would be much more time consuming. It is a more accurate and precise way to budget, but for most hospitals, the increase in accuracy is not worth the substantial increase in time required to prepare the budget at this level, and unless yours is a smaller hospital, it may not even be feasible.

## Chapter 10 Self Review Questions

1. Name three common fixed expenses.
2. If your hospital outsources a patient service, such as interpreting, should that expense be budgeted as a fixed or a variable expense?
3. Even though repairs can vary greatly from month to month, and from hospital to hospital, they are considered to be a fixed expense. Why?
4. If you have a once-a-year expense that typically occurs in the last month of the year, which approach will be best for preparing the forecast for the remainder of the year to ensure that item is captured?
5. If your department spending on forms has totaled \$100,000 through 10 months of the year, and the remaining budget is \$10,000, will applying the prorated approach to forecast the remainder of the year yield an accurate baseline for next year's budget?

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**CHAPTER 10 SELF REVIEW QUESTIONS**

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1. Name 3 common fixed expenses.

**Answer:** There are many. Three examples are: maintenance, repairs, rentals.

2. If your hospital outsources a patient service, such as interpreting, should that expense be budgeted as a fixed or a variable expense?

**Answer:** Unless you have a highly sophisticated budget system, these types of services will likely be budgeted as a fixed expense. It will be important for you, as the person responsible for the budget, to consider if there are reasons why the budget should be increased due to budgeted increases in hospital volume. Likewise, perhaps a new arrangement is being made to bring the service in house. Then the fixed expenses budget may be reduced or eliminated, while staffing may need to be increased (this is an example of a strategic initiative—see Chapter 6 for details on how to approach budgeting such a change)

3. Even though repairs can vary greatly from month to month, and from hospital to hospital, they are considered to be a fixed expense. Why?

**Answer:** Fixed expenses are expenses that although they may vary, they do not vary because of changes in patient volume.

4. If you have a once-a-year expense that typically occurs in the last month of the year, which approach will be best for preparing the forecast for the remainder of the year to ensure that item is captured?

**Answer:** Using the budget for the remaining months. If the YTD actual expenses are pro-rated, the expense will be missed since it has not occurred yet.

5. If your department spending on forms has totaled \$100,000 through 10 months of the year, and the remaining budget is \$10,000, will applying the prorated approach to forecast the remainder of the year yield an accurate baseline for next year's budget?

**Answer:** Probably not. It appears the YTD monthly average has been \$10,000 per month, but the remaining budget is only \$5,000 per month. More information is needed to know for sure. Perhaps a new regulatory requirement was issued, requiring a 1-time forms expense of \$50,000. Excluding that 1-time expense, the monthly average has been \$5,000—making the remaining budget adequate.



**Early praise for Money to Care:**

*“This book puts everything I’ve spent 22 years learning about hospital finances all in one place! I wish it had been written earlier!”*

—Michelle Smith, Chief Nurse Executive, Abrazo Healthcare

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