Speaking the Language of Finance

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OBJECTIVES
Understand the “financials” and why they are important to you
Understand financial statements, financial performance measurements, and some of the “financial jargon”

Professional Practice Model

What
• Care delivery, valued relationships, collaborative decisions, and continued professional growth

How
• With professional values (ICARE)

Why
• Excellent patient outcomes

What we do…How we do it…Why we do it

Financial Management

What
• Support the organization’s mission by being a steward of its’ fiduciary obligations.

How
• Provide the resources necessary to fulfill those goals.

Why
• Excellent Patient Outcomes

Healthcare Spending in the US 2015 - $3.2 TRILLION

Source: Centers for Medicare and Medicaid (CMS)
The Healthcare Finance Players

• Patients
  • Retired/disabled (Medicare)
  • Low Income/assets (Medicaid)
  • Uninsured
  • Employees/Employers
• Payers
  • Federal & State Government
  • Insurance Companies
• Providers of Care (you)
• Suppliers

The Flow of Healthcare Spending

Statement of Operations
(What we earn and spend)

Gross Revenue $957,000,000
Contractual Allowances (468,000,000)
Bad Debt (34,000,000)
Other Income 21,000,000
NET REVENUE (What we earn/collect) 476,000,000
Salaries & Benefits (291,000,000)
Supplies & Other (148,000,000)
Depreciation (17,000,000)
Interest (9,000,000)
TOTAL EXPENSES (What we spend) 465,000,000
Net Operating Income 11,000,000
Investment Income & Other 25,000,000

Gross Revenue

Services performed by staff
• Room & board charge times number of patients in a bed at midnight census.
  • $1000 x 30 patients = $30,000
• Total for all patients in the year equals the revenue for your department

Contractual Allowances

Gross charges not paid by insurers
Medicare & Medicaid legislate how much they will pay
• IP - Per Case based on the DRG (Diagnosis Related Group)
• OP – Based on CPT (Current Procedural Terminology) codes or APGs (Ambulatory Payment Groups)
Fee for service – Paid for services rendered to each patient
### Contractual Allowances

Insurance companies negotiate with Hospitals, Physicians & Pharmacies as to what they will pay for services:

- Percent of billed charges (fewer and fewer)
- Per Diem (fixed amount per day)
- Per Case (fixed amount per type of case)
- Fee schedules (lab, radiology, physicians)
- Risk Sharing – Hospitals, Docs and insurance companies share in any gains or losses (premiums less payments for services).

<table>
<thead>
<tr>
<th>Gross Revenue</th>
<th>$40,000</th>
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</thead>
<tbody>
<tr>
<td>Contractual Allowances</td>
<td>-16,000</td>
</tr>
<tr>
<td>Net Revenue</td>
<td>$24,000</td>
</tr>
</tbody>
</table>

### Patient admitted to hospital for knee replacement

- Gross charges for the entire stay are $40,000
- Reimbursement is based upon a DRG payment
  - Base Rate $8,000
  - DRG Weight 3.0
  - Medicare payment $24,000

### Bad Debt

Bad Debt

- Some patients do not have insurance and are responsible for the entire bill
- Patients are responsible for deductibles and co-payments
- Bad debt is the amount left unpaid by the patient

### Other Income

- Cafeteria Revenue
- Grants
- Interest income
- Parking fees

### Net Revenue

- Cash we have available to pay our employees, vendors and other expenses

### Salaries and Benefits

<table>
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<tr>
<td>Interest Expense</td>
<td>(6,000,000)</td>
</tr>
<tr>
<td>TOTAL EXPENSES</td>
<td>465,000,000</td>
</tr>
<tr>
<td>Net Operating Income</td>
<td>11,000,000</td>
</tr>
<tr>
<td>Investment Income &amp; Other</td>
<td>14,000,000</td>
</tr>
<tr>
<td></td>
<td>25,000,000</td>
</tr>
</tbody>
</table>

### Salaries

- Payments to employees for working
- Payments to employees for ET (V/S/H)

### Benefits

- Hospital share of health, dental, disability
- Hospital share of FICA (social security tax)
- Pension Funding
**Supplies & Other Expenses**

- Medical Supplies
- Building Maintenance
- Utilities
- Malpractice Insurance
- Service Contracts
- Food Costs
- Office Supplies & Forms
- Repair of Equipment
- Laundry & Linen

**Gross Revenue** $957,000,000
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**TOTAL EXPENSES** 465,000,000

**NON-OFFICE EXPENSES**
- Rental of property
- Legal fees
- Insurance
- Insurance (21,000,000)
- Legal fees
- Insurance
- Insurance (21,000,000)

**Net Operating Income** 11,000,000

**Investment Income & Other**
- Donations
- Primarily interest earned on our Board Designated Funds and Restricted Funds

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**Statement of Operations**
(What we earn and spend)

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**NET REVENUE** 476,000,000

**Depreciation**
- Amortized cost of capital purchases (Buildings & Equipment)

**Interest Expense**
- Payment for loans (Similar to interest on your home mortgage)

**TOTAL EXPENSES** 465,000,000

**Net Operating Income** 11,000,000

**Exercise: Apartment Complex**

- You live in an apartment complex.
- Your landlord is making plans for next year and has asked for input.
- You and the other renters want new kitchens.
- Review the income statement for the Apartment complex.
- Where would you spend the money?
- What additional information do you need?
Balance Sheet (What we own and owe)

<table>
<thead>
<tr>
<th>Assets (what we own)</th>
<th>Liabilities (what we owe)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts Payable</td>
<td>$54,000,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>Accrued wages &amp; ET</td>
<td>55,000,000</td>
</tr>
<tr>
<td>Property, Plant &amp; Equipment</td>
<td>Accrued Interest</td>
<td>87,000,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>Accrued Pension</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Other assets</td>
<td>Debt</td>
<td>21,000,000</td>
</tr>
<tr>
<td>Assets with designated use</td>
<td>Other Liabilities</td>
<td>138,000,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>TOTAL LIABILITIES</td>
<td>458,000,000</td>
</tr>
<tr>
<td></td>
<td>Net Assets</td>
<td>286,000,000</td>
</tr>
<tr>
<td></td>
<td>TOTAL</td>
<td>172,000,000</td>
</tr>
</tbody>
</table>

Why do we need Net Income if we are a “Non-Profit”?

- Capital – New & replacement equipment
- Principal on Debt
- Build cash for larger capital needs in the future (buildings)
- Cash for the unexpected
- Increase cash to allow borrowing at lower rates
- No Margin No Mission

Health System’s Flow of Cash

- Cash generated by Net Income (Statement of Operations)
- Increase savings
- Buy equipment
- Pay debt
- Strategic Cash Used (Balance Sheet)

THE JARGON

What is an FTE?

- **Full Time Equivalent**
- 1 FTE = 2080 hours per year
- 2080 hours = 40 hours/week x 52 weeks/year

Example:

- 1 nurse works 40 hrs./week for 48 weeks = 1920/year
- 1 nurse works 32 hrs./week for 46 weeks = 1472/year
- 1 nurse works 16 hrs./week for 48 weeks = 768/year

Two of the nurses earn 200 hours of ET for V/H/S

Total hours = 4560 hours/year divide by 2080 = 2.2 FTEs

Operating Measures

- **Patient Days** – Count of patients in-house at midnight census
- **Observation Days** – Observation Hours/24
- **Average Daily Census (ADC)** – (Total I/P days + Obs Days)/365 (or number of days in period)
- **Annual Occupancy percent** – Total I/P days + Obs days)/(total beds*365)
- **Average length of stay (ALOS)** – Total I/P days/Inpatient discharges
- **Case Mix Index (CMI)** – Average of the DRG weights for all the inpatients.
### Operating Measures

- **Hours per patient day (HPPD)** – Total hours worked / Total Patient days
- **Productivity** – Compares actual results to a Volume Adjusted Budget
  - Budget – 60 FTEs and 10,950 patient days = 11.4 HPPD
  - Actual - 64 FTEs and 11,950 patient days
  - Variance shows you are over by 4 FTEs
  - Volume adjusted budget – 11.4 HPPD times your actual patient days of 11,950 = 65.5 FTEs
  - Actual variance on a volume adjusted basis shows you are under by 1.5 FTEs

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### Key Performance Indicators (KPIs)

- **Operating Margin Percent** – Operating income / Operating Revenue
- **Days Cash on Hand** - (Cash and Cash Equivalents + Long Term Investments) / (Total Expenses / 365)
- **Debt Service Coverage Ratio** – (Total operating income + depreciation + interest + amortization) / Annual Debt Service

### Strategic Planning

“Plans are of little importance, but planning is essential.”
Winston Churchill

- Strategic planning is a process of looking into the future and identifying trends and issues against which to align organizational priorities.
  (UN Strategic Planning Guide)
- Key to a meaningful budget
  - Determine where to spend limited funds
  - Expenditures support a longer term goal
  - Better understanding of why decisions are made
  - Everyone’s efforts move the organization in the same direction

### What is an Operating Budget?

- Plan that estimates our revenue and expenses:
  - The types of patients we will service (Gross Revenue)
  - Amount of cash we will collect for those services (Net Revenue)
  - Number and type of staff needed to deliver the services (Salaries and Benefits)
  - Cost of supplies and other items needed by the patients (Expenses)
  - Costs of “overhead expenses” such as heat, electricity, dietary, cleaning and maintenance
  - Builds a projected Statement of Operations
  - Usually done annually but some organizations budget on a rolling 12 months
What is a Capital Budget?

- Plan that determines which long term assets the organization should purchase such as:
  - New facilities
  - Major renovations to existing facilities
  - New equipment
  - New Technology

THE BUDGET PROCESS

Operating Budget

- Gross Revenue
- Project Volumes (Admissions & Procedures)
- Other Income (interest, donations)
- FTEs, Salaries & Benefits
- Other Expenses (supplies, utilities)
- Capitl Budget
- Gross Revenue
- Staffing Budget Processes

Fixed Staffing Budget

- Budget the same as last year
- Does not adjust for changes on volume
- Does not adjust for changes in procedures performed at bedside
- Does not adjust for acuity

Staffing Budget Processes

- Fixed – Same as last year
- Benchmarks – Overall hours per patient day (HPPD)
- Mgmt Engineering Standards – Hours per patient day by job code plus hours for other procedures
- Acuity Based - Hours by job code based upon acuity
- Matrix – Hours for varying census levels

Benchmarks

- Establish a Benchmark – How many hours (on average) are needed to care for a patient
- Adjusts for changes in volume – multiply the benchmark HPPD by the budgeted number of patient days
- Does not adjust for acuity
- Does not breakout by job code (i.e. RNs vs LNAs)

Management Engineering Standards

- Determine by job code how many hours are needed to care for a typical patient
- Determine by job code how many hours are needed to perform additional procedures
- Adjusts for volume - Multiply these estimates by the budget volume (patient days & procedures)
- Does not adjust for acuity
- Very labor intensive to develop standards
Acuity Based

- Utilize a Nursing Acuity system to track acuity levels of patients
- Determine by job code the necessary staffing needed to care for varying acuity levels
- Adjust for changes in volume – Estimate the acuity for the budget and use to project staffing

Matrix

- Establish a staffing matrix for different ADC levels
- Estimate hours needed to care for 1:1
- Estimate “non-patient care” hours including orientation, education, etc.
- Adjusts for volume
- Adjusts for some acuity by adding hours for 1:1

Sample Matrix (1st shift weekday) Required Patient Care Hours

<table>
<thead>
<tr>
<th>Job Code</th>
<th>Length</th>
<th>ADC</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
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</thead>
<tbody>
<tr>
<td>17100</td>
<td>B</td>
<td>Nurse Manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>17000</td>
<td>B</td>
<td>Resource RN</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>50000</td>
<td>B</td>
<td>Clin Nurse I</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>50000</td>
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<td>Clin Nurse II</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>4</td>
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<tr>
<td>50000</td>
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<td>71000</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

Typical View Healthcare Financials

- Monthly Revenue & Expense Reports by Department – Identifies variances from fixed budget to actuals
- Managers complete variance reports each month explaining areas where budget and actuals differ.
- Senior Leadership presents financial results monthly to the Board and Finance Committee based upon traditional income statement

Another View Healthcare Financials – Service Lines

- Group like patients based upon diagnosis for inpatients
- Group by services received for outpatients (ED patients versus surgical patients)
- Calculate Net Revenue, Costs and Net Income for each Service Line
- Strategically allocate operating and capital resources to service lines
NH’s Insurance Market

- Three major insurance companies (81%)
  - Anthem, Cigna and Harvard
  - Represents both fully insured (275,000 members) and self insured plans
- Marketplace Exchange (Affordable Care Act)
  - 50,000 members
- NH Premium Assistance (NHPAP)
  - 40,000
- The Future ??????

Source: www.NH.Gov/insurance/reports (2015 data)

Healthcare Today – Quality and Cost

- US has the highest per capita health expenditure of developed countries
- US has the 8th lowest life expectancy
- US has the highest percentage of obesity
- Spending more does not mean better quality
- Service ensuring that the patient is getting the right level of care, at the right time, by the right level of care provider, at the right cost with consistent evidence-based interventions and outcomes. Nursing Management Oct 2011

VALUE - The Quality & Cost Link

Healthcare Financial Management Association

Value = Quality

The best outcome at the lowest price

Healthcare is transitioning from Fee for Service to Value based payment

Value Based Payments – Healthcare providers will get paid based upon the level of quality delivered and cost efficiency not just that a procedure was performed.

India’s Narayanna Health

- Established in in India in 2001 as Narayanna Hrudayalaya, a 225 Bed Heart Hospital
- Today has grown to 23 hospitals, 7 heart centers with nearly 5,600 beds

Cardiac by-pass surgery at Narayanna Health

- Performing cardiac by-pass surgery with outcomes at the level of Cleveland Clinic (one of the best in the US)
- Average price of by-pass surgery in the US is $75,000
- HOW MUCH AT Narayanna Health????
Cardiac by-pass surgery at Narayanna Health

- Performing by-pass surgery with outcomes as good at the Cleveland Clinic (one of the best in the US)
- Average price of by-pass in the US is $75,000
- HOW MUCH AT Narayanna Health???

$3,000!!!!

- Even adjusted for US wages the cost is $14,000
- They built a Hospital in the Cayman Islands for "destination healthcare".

Why do we need Net Income if we are a “Non-Profit”?

- No Quality
- No Margin
- No Mission

Clinical and Financial Staff Working Together Toward Success

- Quadruple Aim
  - Quality
  - Patient Experience
  - Staff Engagement
  - Cost

You can make a difference

- Start with your own delivery of care each day – pay attention to the details
- Focus on processes that result in quality patient care
- Evidence based care
- Identify and share ways to improve quality
- Identify and share ways to reduce cost
  - For example missing breaks
    - 8 staff on each shift and half miss their breaks each day (2,190 hours per year)
- Involve staff

Questions and Discussion

Thank you!!

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