

EXH	MOTION Taylor
	White
	APPROVED BY THE REGENTS
	JUL 21 2005

THE UNIVERSITY OF MICHIGAN
 REGENTS COMMUNICATION NOTE

ACTION REQUEST

Subject: University of Michigan Hospitals and Health Centers (UMHHC)
 FY2006 Operating Budget

Action

Requested: Approval

Background:

UMHHC has completed its annual operating budget cycle for the FY2006 Operating Budget. The enclosed Budget is predicated upon a combination of modest inpatient growth, aggressive outpatient expansion, inflationary rate increases, and expense management. It results in a 4% operating margin, which is aligned with the long-term UMHHC capital investment plan.

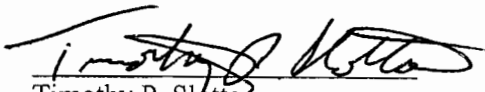
A key change in the FY2006 budget is a worsening of the payer climate. This is reflected in the smallest increase in net revenue per case since FY2001.

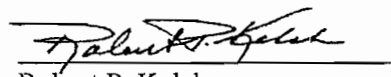
Demand for both inpatient and outpatient services remains high. Significant additional outpatient capacity has been added in late FY2005 and in FY2006 to respond to the demands. Additional bed openings are currently limited by physical space constraints. This budget includes a series of strategies initiated in the current year to create additional capacity on our current beds.

The FY2006 UMHHC Operating Budget reflects a competitive compensation package and incremental increases in expenditures necessary to achieve the activity projections.

We recommend the Regents approve the proposed FY2006 University of Michigan Hospitals and Health Centers' Operating Budget.

Respectfully submitted,


 Timothy P. Slottow
 Executive Vice President and
 Chief Financial Officer


 Robert P. Kelch
 Executive Vice President
 for Medical Affairs

July 2005

University of Michigan Hospitals and Health Centers
Operating Budget Assumptions
FY 2005 Forecast to FY 2006 Budget

Activity

- 3.1% growth in total discharges
- 1.6% decrease in length of stay
- 4.4% growth in operating room cases
- 10.6% growth in outpatient charges prior to rate increase

Revenue

- **Medicare**
 - Market basket increase of 3.2%
 - APC rate increase of 3.0%
 - IME rate decrease of 3.6%
 - Area wage adjustor decrease of 2%
- **Medicaid**
 - DRG rate decrease of 10%
 - Executive order reduction of 4%
- **Blue Cross**
 - Inflation update of 3.8%
 - New contract change of 7M
- **Commercial/other**
 - Rate increase yields 3% increase in net revenue
- **M-Care Commercial**
 - Assigned member increase of 1%
 - Capitation increase of 10%
 - Hospital payment rate increase of 3%
- Minor decline in payer mix
- Risk of further reductions from governmental payers
- Overall revenue per adjusted case increase of 2.1%

Expenses

- Competitive salary program of 3.0 – 5.1%
- Labor Market Funding of \$2.0M
- Support for activity growth and new programs \$30.6M
- Inflation (including utilities) of \$10.4M
- Increased clinical faculty support of \$7.5M
- Contingency, CIF and throughput reserve of \$12.4M
- Overall cost per adjusted case increase of 3.4%

Margin Target

- 4% operating margin target

**University of Michigan Hospitals and Health Centers
Revenue and Expense Changes
FY 2005 Forecast to FY 2006 Budget**

Patient Service Net Revenue Forecast FY 2005	1,314.8 M	
• Changes in activity	72.9 M	
• Change in payer mix	(3.0 M)	
• Change in inpatient charges and "acuity"	9.0 M	
• Change in Medicare rates	2.6 M	
• Changes in Medicaid rates	(7.5 M)	
• Change in Blue Cross rates	18.9 M	
• Change in M-Care rates	1.8 M	
• Change in commercial/other collections	10.5 M	
• Change in professional revenue	1.5 M	
• Change in other revenue	<u>0.7 M</u>	
Patient Service Net Revenue Budget FY 2006	1422.2 M	8.2%
Total Expense Forecast FY 2005	1,247.2 M	
• Activity including new programs	30.6 M	
• Salary program including labor market	25.4 M	
• Contingency/CIF/throughput	12.4 M	
• Insurance/bad debt/interest/depreciation	10.5 M	
• Commodity inflation	10.4 M	
• Operating expenses of capital and OMP	8.7 M	
• Clinical faculty support	7.5 M	
• Other	<u>12.6 M</u>	
Total Expense Budget FY 2006	1,365.3 M	9.5%

UNIVERSITY OF MICHIGAN HOSPITALS AND HEALTH CENTERS
FY2006 OPERATING BUDGET
(Dollars in Millions)

	FY2005 Budget	FY2005 Forecast	FY2006 Proposed Budget	FY2006 Budget vs FY2005 Forecast	
				\$ Variance	% Variance
Operating Revenue					
Facility	\$1,221.9	\$1,238.6	\$1,343.7	\$105.1	8.5%
Professional	63.6	65.3	66.9	\$1.6	2.5%
Total Patient Revenue	1,285.4	1,303.9	1,410.6	106.7	8.2%
Other Operating	11.9	10.9	11.6	0.7	6.2%
Total Operating Revenue	\$1,297.3	\$1,314.8	\$1,422.2	\$107.4	8.2%
Operating Expenses					
Payroll	\$688.5	\$687.5	\$746.4	\$59.0	8.6%
Supplies	240.2	253.5	272.1	18.7	7.4%
Other Non-salary	309.6	306.3	334.3	28.0	9.1%
Subtotal	1,238.3	1,247.2	1,352.9	105.7	8.5%
Contingency/CIF/Throughput	7.2	-	12.4	12.4	
Total Expenses	\$1,245.5	\$1,247.2	\$1,365.3	\$118.1	9.5%
Operating Margin	\$51.9	\$67.6	\$56.9		
Margin Percentage	4.0%	5.1%	4.0%		