

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

Approved by the Regents

July 21, 2006

ACTION REQUEST

Subject: University of Michigan Hospitals and Health Centers (UMHHC)
FY2007 Operating Budget

Action

Requested: Approval

Background:

UMHHC has completed its annual review of operating assumptions and requirements to present the FY2007 Operating Budget. The enclosed Budget is predicated upon a combination of inpatient growth, outpatient expansion, inflationary rate increases, and expense management. It results in a 4% operating margin plan, which is aligned with the long-term UMHHC strategic financial plan.

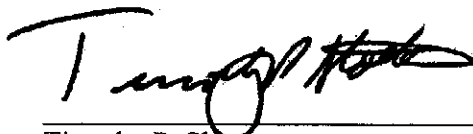
Key points of emphasis during the FY 2007 budget year include productivity improvement, capacity creation and resource optimization.

The demand for inpatient and outpatient services is expected to continue to increase. New inpatient bed openings are limited by space constraints in FY2007. The opening of an observation unit and an ongoing emphasis on throughput and length of stay initiatives will create capacity within existing resources to accommodate growth in inpatient care. Outpatient capacity has been added through offsite expansion.

Revenue per case growth is expected to be lower than in recent years, as governmental payers and insurers aim to reduce the rate of growth.

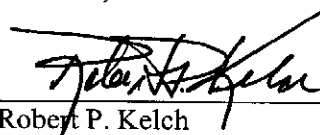
The FY2007 UMHHC Operating Budget reflects a competitive compensation package and incremental funding allocations necessary to achieve the activity projections and operating margin results.

We recommend the Regents approve the proposed FY2007 University of Michigan Hospitals and Health Centers' Operating Budget.



Timothy P. Slottow
Executive Vice President and
Chief Financial Officer

Respectfully submitted,



Robert P. Kelch
Executive Vice President
for Medical Affairs

July 2006

**University of Michigan Hospitals and Health Centers
Operating Budget Assumptions
FY 2006 Forecast to FY 2007 Budget**

Activity

- 3.1% growth in total discharges
- 1.4% decrease in length of stay
- 3.6% growth in operating room cases
- 9.7% growth in outpatient charges prior to rate increase

Revenue

- **Medicare**
 - Market basket increase of 3.4%
 - APC rate increase of 3.0%
 - IME rate decrease of 4.5%
 - Area wage adjustor decrease of 1%
- **Medicaid**
 - No significant changes in budget
- **Blue Cross**
 - Inflation update of 4.1%
 - East Ann Arbor Surgery paid at lower rates (-\$4.4 million)
- **Commercial/other**
 - Rate increase yields 5% increase in net revenue
- **M-Care Commercial**
 - Assigned member increase of 1%
 - Capitation increase of 8%
 - Hospital payment rates increase of 2.5% to 3% on 1/1/07
- Minor decline in payer mix
- Increase in inpatient case-mix index of 1%
- Risk of further reductions from governmental payers
- Overall revenue per adjusted case increase of 2.5%

Expenses

- Competitive salary program of 3.0 to 5.1%
- Labor Market Funding of \$2.0M
- Support for activity growth and new programs \$46.8M
- Inflation (including utilities) of \$17.7M
- Increased clinical faculty payments of \$9.1M
- Operating costs of OMP of \$9.4M over 2006
- Startup costs of CVC of \$8.7M
- Contingency reserve of \$4.3M
- Overall cost per adjusted case increase of 4.2%

Margin Target

- 4% operating margin target

**University of Michigan Hospitals and Health Centers
Revenue and Expense Changes
FY 2006 Forecast to FY 2007 Budget**

Patient Service Net Revenue Forecast FY 2006	1,418.7 M	
• Changes in activity	76.4 M	
• Change in payer mix	(1.4 M)	
• Change in inpatient case-mix and outliers	5.5 M	
• Change in Medicare rates	3.2 M	
• Changes in Medicaid rates	0.1 M	
• Change in Blue Cross rates	15.0 M	
• Change in M-Care rates	2.8 M	
• Change in commercial/other collections	15.6 M	
• Change in professional revenue	<u>2.8 M</u>	
Patient Service Net Revenue Budget FY 2007	1,538.7 M	8.5%
Total Expense Forecast FY 2006	1,350.9 M	
• Activity including new programs	46.8 M	
• Salary program including labor market	28.0M	
• Contingency	4.3 M	
• Commodity inflation	17.7 M	
• Operating expenses of capital and OMP	11.9 M	
• Cardiovascular Center start-up	8.7 M	
• Insurance/bad debt/interest/other depreciation	12.5 M	
• Clinical faculty support	9.1 M	
• Management actions to reduce cost	(9.5) M	
• Other	<u>7.0 M</u>	
Total Expense Budget FY 2007	1,487.4M	10.1%

UNIVERSITY OF MICHIGAN HOSPITALS AND HEALTH CENTERS
FY2007 OPERATING BUDGET
(Dollars in Millions)

	FY2006 Budget	FY2006 Forecast	FY2007 Proposed Budget	FY2007 Budget vs FY2006 Forecast	
				\$ Variance	% Variance
Operating Revenue					
Facility	\$1,343.8	\$1,353.9	\$1,469.4	\$115.5	8.5%
Professional	66.6	64.8	69.3	4.5	6.9%
Total Patient Revenue	1,410.4	1,418.7	1,538.7	119.9	8.5%
Other Operating	10.5	10.7	11.0	0.3	2.9%
Total Operating Revenue	\$1,420.8	\$1,429.4	\$1,549.6	\$120.2	8.4%
Operating Expenses					
Payroll	\$753.3	\$746.0	\$816.9	\$71.0	9.5%
Supplies	275.9	279.2	296.8	17.7	6.3%
Other Non-salary	328.9	325.8	369.4	43.6	13.4%
Subtotal	1,358.1	1,350.9	1,483.1	132.2	9.8%
Contingency/reserves	5.9	-	4.3	4.3	
Total Expenses	\$1,364.0	\$1,350.9	\$1,487.4	\$136.5	10.1%
Operating Margin	\$56.9	\$78.4	\$62.2		
Margin Percentage	4.0%	5.5%	4.0%		