HFMA CHFP Certification Series
Article 3 - Budgeting and Forecasting

The third module in the certification preparation materials is *Budgeting & Forecasting*. This area comprises between 18% and 22% of the exam. The Functional focus of this module:

- Data collection & analysis
- Projections
- Capital planning
- Cash flow
- Budget analysis & monitoring
- Financing options

Broadly defined, a budget, is a formal plan for future operations expressed quantitatively. Forecasting is the application of financial management techniques to determine if operations are producing desired results and will continue to do so. Note the scope and integration of the content area.

Within the exam there are fundamental areas to note: 1) data collection 2) projections 3) budgeting These three areas comprise more that ½ the test-items in this content area. The following is a brief overview of the concepts assessed in each area.

<u>Data Collection</u>

Developing a budget requires data collection. Completing a comprehensive budget requires a great deal of coordination that increases significantly with the organization's size. data collection includes items such as:

- historical data on costs and volumes by accounting periods
- the volume of activities (patient visits, tests, surgeries, etc)
- Current and anticipated expenses and revenues
- Capital needs
- Rates

Data is collected to be employed in the budgeting process. Most organizations are familiar with the annual operating budgets. However, to be most effective, the budgeting process should be incorporated into the overall planning process beginning with the highest level strategic initiatives, from which concrete tactics are developed and then translated into an operating plan.

<u>Projections</u>

This is a process of measuring performance often requires the use of statistical evidence to determine progress toward specific defined organizational objectives.

Budgets are crude tools in improving performance. Poor performance not always may change after applying budgets cuts as a disciplinary action. Sometimes budgets increase could be the answer to improving performance. Like purchasing better technology because the current ones are outdated and harm operational processes. So decision highly influenced by circumstance, you need measures to better understand the situation.

Forecasting objectives include:

- Forecasting cash needs—Correct forecasting of the organization's financial needs in the short-, intermediate- and long-term involves an understanding of the management of transactions and a basic understanding of the concepts of revenues, expenses, and cash paid or received within them.
- Valuing the organization, products and services— which valuation is required in order to raise capital? The financial model and discussion related to its underlying assumptions often serve as a basis for the associated debt covenants.
- Comparing actual performance to objectives— such comparison is important in order to amend forward-looking forecasts and to adjust them to reality, and for adequate control over the pace of outflow of expenses. Such a comparison is important also to creditors, since it can warn them of changes in the probability of the organization meeting performance milestones.

Financial Performance Measurement

Financial performance measurement employs ratios to express the relationships of financial data derived from activity outcomes. There are 3 families of ratios:

- Liquidity: measures the short-term ability of the organization to pay its maturing obligations and to meet unexpected needs for cash. Short term creditors such as suppliers are interested in assessing liquidity.
- Solvency: measures the ability of the organization to survive over a longer period of time. Long-term creditors (and stockholders) are interested in an organization’s long-run solvency particularly its ability to pay interest as it comes due and to repay the face value of debt at maturity
- Profitability: measures the income or operating success of an enterprise for a given period of time. An organization’s income, or lack of it, affects its ability to obtain debt and equity financing, its liquidity position, and its ability to grow.

Cash flow

Planning cash needs is a key business activity. The ***cash budget*** is a product of the operating and capital budget. This budget predicts the cash flow and cash availability, and the income generated from operations and other sources of cash.

The cash budget may be considered the most important part of the annual budgeting process.
It allows the organization to plan for its continuous solvency; that is, to have the ability to pay bills when due and to avoid unnecessary idle cash or cash deficiencies by timing significant disbursements and implementing a timely borrowing, repayment, and investment policy.

Cash budgeting

Total Cash Available

In general, this is equal to the beginning cash balance, collections from patients and payers, proceeds from planned borrowings, proceeds from liquidated investments, and proceeds from dispositions of long-term assets.

Total Cash Disbursements

In general, this is equal to the cash outflow for operations (for purchases and other operations), outflows for long-term debt, scheduled principal and interest payments, and outflows for acquisition of long-term assets.

Total Cash Needed
In general, this is equal to the total disbursements and a minimum cash balance the organization wants to maintain as an operating reserve.

Any organization can improve the opportunities of having adequate cash by following these five principles:

- Increase speed of collections on receivables
- Keep inventory low
- Delay payment of liabilities
- Plan the timing of major expenses
- Invest idle cash

Note the Interrelationship of Budgets in figure 1. All three of these budgets are highly interrelated. The operating plan impacts the capital budget, which in turn impacts the operating budgets. The operating budgets determine cash availability that in turn influences the capital budget. All three of the budgets should be prepared and validated before the annual budgets are adopted.

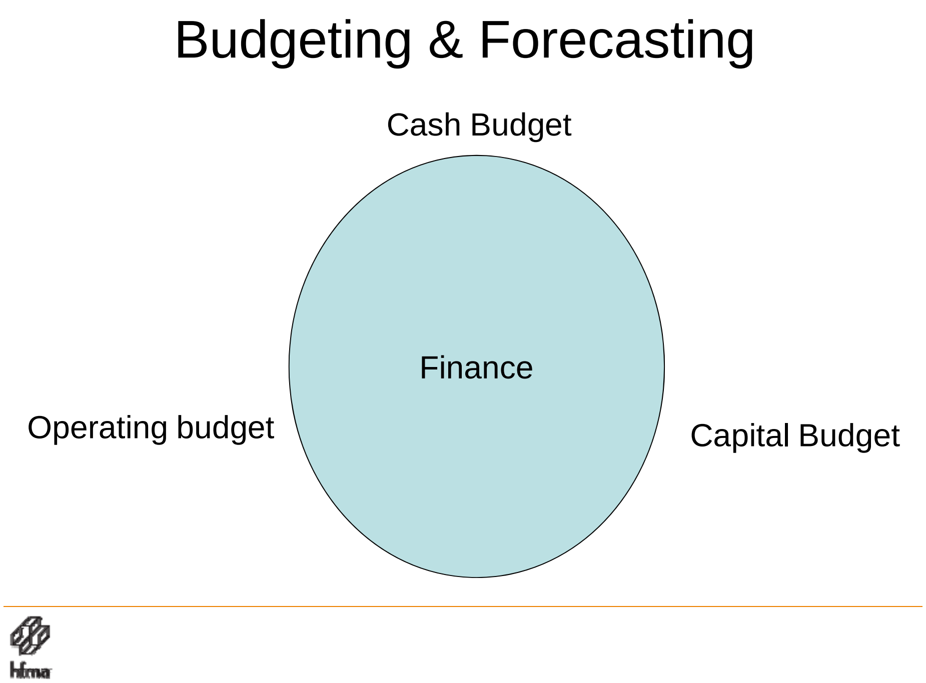

Figure 1 Budgeting & Forecasting Function

An integrate view of budgeting in the context of financial management is provided in figure 2.

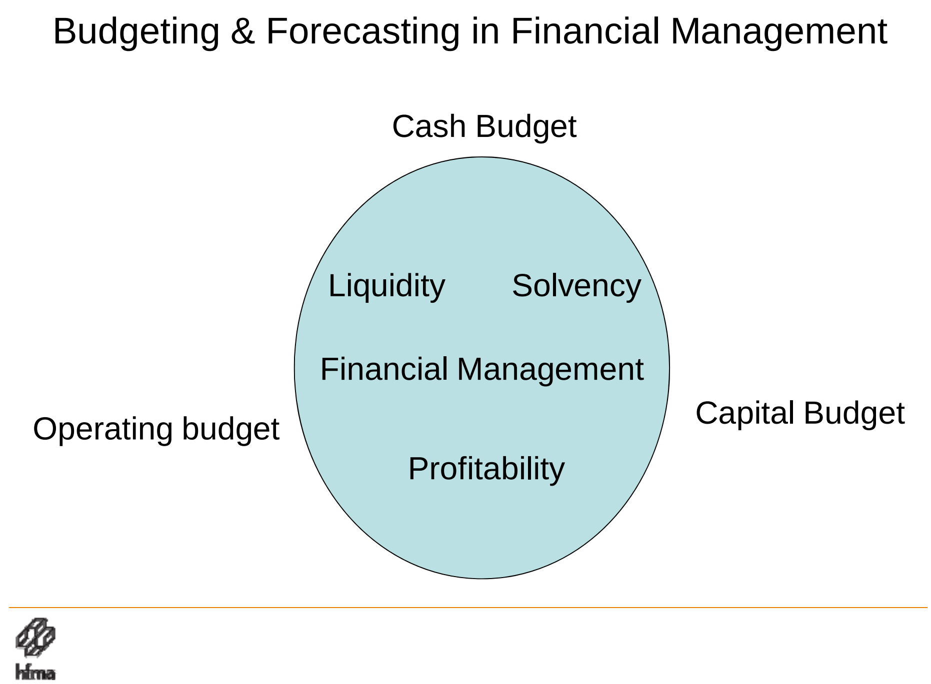

Figure 2 Budgeting and Financial Management