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pioneering a rolling forecast

A North Carolina health system that switched from a traditional to a rolling budget process found the conversion offered a unique perspective of its financial picture.

AT A GLANCE

Switching from a traditional annual budgeting process to a rolling forecast has enabled Asheville, N.C.-based Mission Health to respond more quickly to changing conditions and redirect financial resources to needed areas. The new approach also has enabled Mission Health to:

- > Focus on continuous improvement rather than zero-based budgeting
- > Provide clear and actionable reporting on profitability and productivity to drive accountability and results
- > Redeploy millions of dollars in resources traditionally spent on the annual budget
- > Eliminate non-constructive (use it or lose it) behavior embedded in traditional budgeting

As the healthcare industry has continued to undergo extraordinary change to meet more demanding value expectations, many healthcare organizations are finding that their budgeting process is requiring them to redirect an excessive amount of staffing away from the health system's mission to redesign care processes to meet value-based goals. The process across the board has become expensive, time consuming, and inefficient. Mission Health, a health system based in Asheville, N.C., was experiencing these challenges just two years ago.

Mission Health comprises a 763-bed regional tertiary and quaternary care medical center, five community-based general acute care and critical access hospitals, a long-term acute care hospital, an inpatient facility for acute rehabilitation, and a robust physician enterprise with more than 775 networked providers.

For the past six years, the health system has focused on solidifying its position as a nationally ranked healthcare provider, building core capabilities to manage population risk, and expanding into more communities. Its budget process, however, was becoming cumbersome. Dozens of finance executives, managers, and staff devoted entire summers preparing for the new fiscal year in October. The process, which cost millions of dollars, threatened to paralyze the system's ability to adapt to and thrive in a new healthcare environment.

In 2014, Mission Health decided to leave the annual budgeting process behind and embark upon a new approach involving a rolling forecast.

CASE STUDY

The system's objectives included attaining:

- > A more timely and flexible process for near-term projections
- > A quicker line of sight into opportunities for margin improvement
- > A top-down process focused more on continuous improvement than on zero-based budgeting
- > A process that would be easily scalable and would not quickly grow stale in a rapidly changing environment

To adopt this new approach, Mission Health required a new process, new tools, and a new mindset.

Annual Versus Rolling

A rolling forecast differs fundamentally from a traditional annual budget in terms of its time frame and the level of detail required for its analysis. First, a traditional budget calls for financial planning once a year while a rolling forecast uses a continuous planning cycle, such as monthly or quarterly (depending on available manpower). Second, a traditional budget provides a more granular review of financials than a rolling forecast.

At Mission Health, the annual budget detailed line-item revenue and expenses at the department level and the account level. In contrast, the system's rolling forecast is a quarterly summary of revenue and expenses at the entity level—encompassing the seven hospitals, physician enterprise, and several other entities, including specialty hospitals.

A rolling forecast also differs from traditional budgeting in how performance is monitored. The focus of performance shifts from meeting a set budget figure to meeting efficiencies in labor and workload productivity. Performance is measured by unit of service for every department (e.g., FTE, patient revenue, and expense).

Because the traditional budgeting process occurs only once annually, performance is compared with financial targets that are set at the beginning of the fiscal year. By contrast, Mission's rolling

forecast is updated each quarter and compares to desired outcomes for the current and following year. This approach allows an organization to monitor continuous improvement with the expectation of year-over-year growth and productivity improvement.

Moreover, fewer staff resources are required for a rolling forecast process than for an annual budgeting process. Before Mission Health switched to a rolling forecast, its budgeting process required finance and accounting teams based at each entity. That structure has now been consolidated to one centralized team, called the financial planning team, which drives the structure and administration of the quarterly process at the system level. Instead of having a complete, separate finance team, each entity now requires a regional finance director and a financial analyst who work with clinical and operational leaders to gather up-to-date data in areas such as volume, expenses, and reimbursement, to be incorporated into the rolling forecast by the financial planning team. Those teams are accountable for completing the forecast update each quarter.

Developing the Forecast

A year of planning went into the rolling forecast implementation, including determining how the rolling forecast would work and educating key players, such as senior leadership, the financial planning team, and the board of directors for each facility.

The five components of Mission Health's rolling forecast approach include the long-range financial plan (updated at least biannually), the rolling forecast itself, margin improvement efforts, operating targets and monitoring, and management reporting and accountability.

The long-range financial plan sets the framework for the targeted level of profitability and capital spend over a five- to 10-year period. There is a direct link between the near-term rolling forecast and the annual long-range financial plan as

assumptions in the rolling forecast are carried as a starting point into the plan.

Similar to the annual budgeting process, Mission Health's rolling forecast is developed for each entity, including the seven hospitals, the physician enterprise, and other entities and service lines, for a total of 55 plans. Each quarterly forecast projects financials for the current fiscal year and the following fiscal year. The central financial planning team then consolidates these forecasts into one forecast for the health system.

The forecast includes revenues based on inpatient and outpatient volume, discharges, surgeries, and expected levels of payment, plus projected expenses broken down into subcategory, such as supplies, contract labor, purchased services, and salaries.

Operating targets are allocated for each facility and established based on sustainability targets that define the required level of improvement necessary to meet profit margins. The central financial planning team, along with the regional finance directors, monitors performance by comparing the quarterly forecasts with the long-range financial plan to determine if there are gaps between targets and actuals.

The fourth quarter rolling forecast effort establishes the subsequent year's annual performance based targets such as total margin, operating margin, and cash flow margin. These targets, presented as leadership's commitment to the board of directors, are set at the beginning of the fiscal year and do not change.

The final component of Mission Health's continuous planning cycle is management reporting and accountability, which consists of monitoring whether frontline managers adhere to relative performance targets rather than to fixed budget targets. Managers are held accountable for maintaining or improving performance across a comprehensive, yet straightforward set of performance targets (e.g., revenue per unit of service, salaries per unit of service, supplies per

unit of service). When targets are not met, entity-based finance teams and frontline managers are responsible for taking corrective measures to improve performance. Mission Health is currently at this stage.

Changing Mindsets

Educating finance teams that were responsible for building the forecasts is one of the major hurdles of implementing a rolling forecast. In this area, there's no substitute for experience. Teams must learn as they go and be flexible and open to change.

Changing the mindset of frontline managers regarding budgetary control and performance accountability can be a tremendous challenge for a health system, but it also presents a tremendous opportunity because the rolling forecast approach fosters a vehicle for continuous improvement, which is a requirement of value-based care.

Helping frontline managers understand the value of a rolling process, however, is instrumental to gaining buy-in. The traditional budgeting process fosters siloed behavior, provokes fiscal irresponsibility, and stymies teamwork because departmental managers tend to view budgets as a security blanket with leeway to spend the entire budget.

Managers at Mission Health were educated on the key disadvantages of a traditional budget, including the following:

- > Budgets become outdated quickly after being completed.
- > Significant human and financial resources are consumed during the summer months when time off is important for rejuvenation. (Freeing up that time proved to be a key selling point.)
- > Rapid response to unpredictable events and a changing environment is hard to achieve.
- > Because leaders are traditionally apt to make decisions based on budget availability, department teams are demotivated to drive clinical and financial value where initiative and innovation are prized.

CASE STUDY

With a rolling forecast, the frontline managers must shift their mindset from “meeting my budget” on an annual basis to meeting productivity and cost efficiency targets on a continuous basis. The organization must become more agile to adjust to changing conditions. And the department managers must understand their link to the overall key performance indicators (i.e., operating margin, cash flow margin, total margin, compensation ratios, and supply expense).

Mission Health currently is educating frontline leaders about the relationship between performance and the shift to value-based payment from fee-for-service. Payers are beginning to gauge the performance of the overall health system on value, which means that individual departmental performance will, in turn, be gauged on efficiency-based targets.

Making It Work

With any systemwide change, various elements along the way can either propel the process or halt it altogether. The following elements are essential success factors.

Support from senior executives and directors. For the rolling budget conversion to work, senior executive and board members must agree that the traditional budgeting process produces stale numbers and needs revamping.

Information systems that can supply the necessary data. The annual budget platform might need to be replaced with an information system that syncs the data of the long-range financial plans and the forecasts. At Mission Health, the forecast platform is directly linked to actual financial performance to enable projection updates within the latest financial trends.

The technology should be scalable across the health system, easily administered from the corporate office, and available to the forecast teams each quarter for updated inputs. The system also should identify gaps between targets set in long-range financial plans and projections

in the quarterly forecasts and then identify the required level of needed improvement.

At Mission Health, another tool was developed for reporting monthly activity on labor management, labor productivity, labor benchmarking, and cost per unit of service for use by frontline leaders, who receive the data in an electronic format.

A high-level view of financials. Choosing to produce high-level forecasts (e.g., at the entity level rather than the department level) also can be instrumental in creating a sleeker, more streamlined financial forecasting process. Going too deeply into the financials of each entity could lead to the production of a detailed budget four times a year, rather than annually, defeating the purpose of moving to a rolling forecast, which is to reduce time and staff time expended on the budget.

A culture of accountability. Ensuring accountability at the manager level is another critical element for success with a rolling forecast approach. Lacking a means for measuring their performance, managers are likely to become frustrated, impeding progress.

However, once a manager has embraced a rolling forecast mindset and no longer is inclined to say, “I have the money, so I’m going to spend it,” the question for the manager becomes, “What expectations do I manage to?”

To help managers answer this question, health systems should consider retraining them on managing to a trend, with targets in cost per unit of service, which translates into running their areas more efficiently than in prior periods. Their main focus is now meeting and tracking key performance indicator targets. This result is a complete shift in thinking for a frontline manager because he or she is no longer managing to budget, but to an efficiency expectation, which represents a change in core competency.

In sum, a rolling forecast approach requires decision making to focus not on whether there is money in the budget but on whether a decision

will be good for patients, have a positive financial impact for the entity, and reduce cost and waste.

Good Going, So Far

Mission Health's first rolling forecast was developed in the summer of 2015, the third quarter of its fiscal year, and forecasted six quarters—through the remainder of FY15 and all of FY16. The second forecast, completed in Q4 of FY15 memorialized Mission's new performance targets for FY16.

Already, the system is projecting gaps and areas that will need improvement. Had the system stayed with the traditional budget process, those gaps would not have been identified for several more months. For example, through the updates at the second quarterly forecast, Mission Health predicted cost would need to be reduced by \$14 million meet its financial objectives. The gap between costs and revenue resulted from unforeseen reductions in Medicaid payments and reduced savings in the 340B drug pricing program. The teams at each entity were directed to develop mitigation plans for closing the gap, and those ideas have been prioritized for implementation. Ideas range from reduced use of contract labor to renegotiation of supply implants. Monthly progress reports show that the system is on track to substantially close the \$14 million gap.

Currently, Mission Health is in the process of determining how many mitigation plans can be extended into the next fiscal year and how many plans (because of their timeline and process implementation) may require more time. Due to flat to declining payment combined with cost pressures such as labor and drug costs (the healthcare math problem), the system has found that a higher level of improvement is needed to meet desired FY17 margins.

Preparing for Now

Taking on new approaches that enable a health-care organization to meet the constant change and challenges of the value-based care era is critical for sustainability. To be sure, an organization that undergoes such substantial change will not get everything right from the start. The learning curve may be considerable, so patience and preparation are necessities. Remember, the rolling forecast is not a cookie-cutter solution but a tool that will look and work differently for different organizations.

Fundamentally, the rolling forecast helps bring finance leaders and departmental managers together on the same page, rather than working in silos with lack of coordination on targets, and it requires decision making based on a balance between high quality and cost efficiency so that patients receive the care that best meets their needs.

Mission Health's journey demonstrates that an onerous, seemingly immobile process can be transformed into a more fluid, useful tool for identifying financial gaps that could impede an organization's ability to deliver care as cost efficiently as possible. Using a rolling forecast is enabling Mission Health frontline managers to become true financial stewards of their departments, even as the health system is becoming better prepared for delivering value. ■

About the author



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