

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

Approved by the Regents
July 19, 2007

ACTION REQUEST

Subject: University of Michigan Hospitals and Health Centers (UMHHC)
FY2008 Operating Budget

Action
Requested: Approval

Background:

UMHHC has completed its annual operating budget cycle for the FY2008 Operating Budget. The enclosed Budget is predicated upon a combination of strong patient growth and expense management. The activity, revenue and expense projections result in a 3% operating margin, aligned with the long-term UMHHC Strategic Financial Plan.

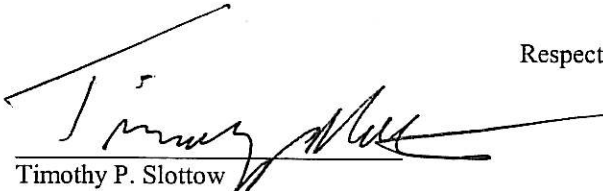
The reimbursement climate for health care is expected to continue as a significant challenge in FY 2008.

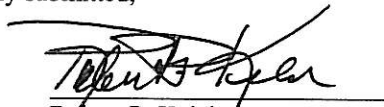
Demand for both inpatient and outpatient services remain high. Additional inpatient beds are planned for the new fiscal year, providing increased access to meet growing patient demands. This budget includes an ongoing commitment to productivity improvement and cost effectiveness strategies across inpatient and outpatient areas.

The FY2008 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 FY2008 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, 2007

**University of Michigan Hospitals and Health Centers
Operating Budget Assumptions
FY 2007 Forecast to FY 2008 Budget**

Activity

- 5.4% growth in total discharges and observation cases
- 9.5% growth in outpatient activity
- 14.5% increase in adult bed capacity over 18 months
- 12 additional operating rooms

Revenue

- Medicare net inflation increase of 1.3%
- No Medicaid inflation increase in budget
- Positive impact of moving from M-Care rates to Blue Cross rates on 1/1/08
- Continued shift of payer mix from commercial insurance to governmental payers
- Risk of payment reductions from governmental payers as government FY2008 budget unfolds

Expenses

- Competitive salary program of 3.0 to 3.2%
- Labor Market Funding of \$2.0M
- Support for activity growth and supply inflation \$45.0M
- Increased clinical faculty payments of \$14.0M
- Operating costs of CareLink of \$7.0M over 2007
- Contingency reserve of \$14.0M
- GASB 45 accounting change impact of \$27M
- Added depreciation costs of \$22M

Margin Target

- 3% operating margin target, consistent with long term financial plan

**University of Michigan Hospitals and Health Centers
Revenue and Expense Changes
FY 2007 Forecast to FY 2008 Budget**

Operating Revenue Forecast FY 2007	1,560.0 M	
• Increase in patient activity	111.8 M	
• Other changes in payer mix	(5.1 M)	
• Change in inpatient case-mix, DRG payers	2.2 M	
• Change in reimbursement rates	67.1 M	
 Operating Revenue Budget FY 2008	 1,736.0 M	 11.3%
 Total Expense Forecast FY 2007	 1,497.0 M	
• Activity increases and supplies inflation	45.0 M	
• Salary program including labor market	33.0 M	
• Accounting change for retiree benefits	27.0 M	
• Contingency	14.0 M	
• Depreciation	22.0 M	
• Insurance/bad debt/interest/other	17.0 M	
• Clinical faculty support	14.0 M	
• CareLink operating	7.0 M	
• Other	8.0 M	
 Total Expense Budget FY 2008	 1,684.0 M	 12.5%

UNIVERSITY OF MICHIGAN HOSPITALS AND HEALTH CENTERS
FY2008 OPERATING BUDGET
(Dollars in Millions)

	FY2007			FY2008		
	Budget	Forecast	Variance	Budget	Change	% Change
Operating Revenue	\$1,550.0	\$1,560.0	\$10.0	\$1,736.0	\$176.0	11.3%
Operating Expenses						
Payroll	\$822.9	\$828.0	(\$5.1)	\$930.0	\$102.0	12.3%
Supplies	300.0	303.0	(\$3.0)	320.0	\$17.0	5.6%
Other Non-salary	364.9	366.0	(\$1.1)	420.0	\$54.0	14.8%
Subtotal	1,487.8	1,497.0	(9.2)	1,670.0	\$173.0	11.6%
Contingency/reserves	-	-	-	14.0		
Total Expenses	\$1,487.8	\$1,497.0	(\$9.2)	\$1,684.0	\$187.0	12.5%
Operating Margin	\$62.2	\$63.0	\$0.8	\$52.0		
Margin Percentage	4.0%	4.0%		3.0%		