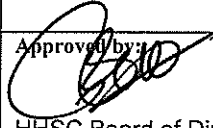
 <p>HAWAII HEALTH SYSTEMS CORPORATION "Touching Lives Everyday"</p>	<p>Department: Corporate Finance</p>	<p>Policy No.: FIN 0014</p>
	<p>Issued by: Kelley Roberson COO/CFO</p>	<p>Revision No.: N/A</p>
<p>Policies and Procedures</p>	<p>Approved by:  HHSC Board of Directors By: Raymond Ono Its Secretary/Treasurer</p>	<p>Effective Date: August 21, 2008</p>
<p>Subject: Government Budgeting</p>		<p>Supersedes Policy: N/A</p>
		<p>Page: 1 of 7</p>

I. PURPOSE: To provide policy and guidelines and description of processes for the development of facility-level and regional budgets for consolidation by the Hawaii Health Systems Corporation into a system budget for submission as part of the Executive Biennium Budget of the State of Hawaii or the Executive Supplemental Budget of the State of Hawaii. Separate Operating Budgeting Policy (FIN 0013) is provided concerning final year budgeting requirements at regional and facility levels.

II. DEFINITIONS:

Budgeting: The process of translating planning and programming decisions into specific projected financial plans for relatively short periods of time. A budget is an itemized summary of estimated or intended expenditures for a given period along with proposals for financing them.

Budget Year: Budget year for State of Hawaii government, including Hawaii Health Systems Corporation and component regions of HHSC is from July 1 through June 30.

Biennium Budget: Every two years the Governor submits an executive biennium budget that the Hawaii Legislature considers in development of a biennium budget that appropriates funds (both general funds and special funds) and sets spending ceilings for both general funds and special funds. First year of each biennium period is an even-numbered year (such as fiscal year 2010, the year ending June 30, 2010). Second year of each biennium budget period is an odd-numbered year (such as fiscal year 2011, the budget year ending June 30, 2011). A biennium budget is passed by the Hawaii Legislature in the odd-numbered year preceding the first, even-numbered year of the biennium.

The Executive Biennium Budget: No fewer than thirty days before the Hawaii Legislature convenes in every odd-numbered year, the Governor shall submit the Executive Biennium Budget to the Legislature for consideration. In the year before the beginning of a budget biennium, the Department of Budget & Finance will issue biennium budget guidance to departments and agencies of the state (such as HHSC), requiring submission of expenses & revenues for the two biennium years and submission of requirements for general funds, special funds, and capital improvement project funding.

Budget Base: Biennium budget guidance may include general funds subsidy amount the Department has determined to be the budget "base" for the department or agency, based on funding in prior years.

Supplemental Budget: A supplemental budget is submitted to the Legislature to reflect changes to the biennial budget. A supplemental budget is passed by the Hawaii Legislature during the first year of the biennium so that additional funds will be made available during the second year of the biennium. Similar to the process for biennium budget submissions, the Governor submits an Executive Supplemental Budget to the Hawaii Legislature that the Legislature considers in development of a supplemental budget that appropriates funds (both general funds and special funds) and may set spending ceilings for both general funds and special funds.

The Executive Supplemental Budget: Not fewer than thirty days before the Legislature convenes in every odd-numbered year, the Governor shall submit the supplemental budget to the Legislature for consideration. Normally, in the year before the beginning of the supplemental budget year, the Department of Budget & Finance will issue supplemental budget guidance to departments and agencies of the state (such as HHSC), providing procedures for submission of requests for general funds and special funds amounts beyond what was legislated in the previous legislative session and also for submission of requests for additional CIP projects, beyond what was appropriated in the previous legislative session. These submissions may request increases to general fund and special funds spending ceilings as well.

Operating Budget: An operating budget is the annual budget of an activity stated in terms of Budget Classification Code, functional/subfunctional categories and cost accounts. It contains estimates of the total value of resources required for the performance of the operation including reimbursable work or services for others. It also includes estimates of workload in terms of total work units identified by cost accounts. Operating budget policies and procedures are not part of the Government Budgeting policy.

Accrual Accounting: HHSC budgeting and financial reporting, including annual audited financial statements utilize accrual basis accounting, which is the accounting method whereby income and expense items are recognized as they are earned or incurred, even though they may not have been received or actually paid in cash. The alternative is cash basis accounting. Under the accrual method, companies do have some discretion as to when income and expenses are recognized, but there are rules governing the recognition. In addition, companies are required to make prudent estimates to report revenues, expenses, assets and liabilities. Actual cash results can differ from these accrual estimates.

Cash Flow Budget: A cash flow budget is a plan of the cash inflows and outflows of an enterprise over a certain period of time. A cash flow forecast is a projection of cash inflows and outflows over a period of time. A typical cash flow budget plans the anticipated cash receipts and disbursements of a business on a month-to-month basis. However, a cash flow budget could plan the cash inflows and outflows on a weekly or daily basis. Because of the uncertainty involved in the cash flow budget, trying to project too far into the future may prove to be less than worthwhile. At the same time, a cash flow budget that doesn't look far enough into the future will not predict future events early enough for you to take corrective action in your cash flow.... The primary purpose of using a cash flow budget is to plan for the use of credit or other capital resources during periods when the enterprise must pay out more cash than it takes in. This identifies the cash resources necessary to sustain the enterprise during periods of operating losses, expansion or heavy capital investment. The cash flow budget plans for cash flow gaps — periods when cash outflows exceed cash inflows when combined with your cash reserves. The cash flow budget identifies the actions management will take to ensure that the gaps are closed, or at least narrowed, when they are predicted by the cash flow forecast. Cash flow budgeting is necessary to develop general fund subsidy requirements for facilities and regions for submission through HHSC to the administration and the legislature as part of biennium and supplemental budget requests.

Capital Budget: Plan of proposed acquisitions and replacements of long-term assets and their financing. A capital budget is developed using a variety of capital budgeting techniques such as the

payback method, the net present value (NPV) method, or the Internal Rate of Return (IRR) method. For HHSC Regions, priority may be given to capital budget items that would not meet payback or NPV or IRR thresholds but that are necessary to replace aging/failing equipment or facilities to continue vital missions or to upgrade to new technology/ies to maintain state-of-the art levels of services.

Capital Improvements Project (CIP) Budget (State-Funded): As part of the biennium budget, the state of Hawaii authorizes capital improvement projects (CIP) that are paid from the general funds of the State. Authority for management of the funds and the projects can be given to HHSC through the Department of Health, or to the Department of Administration and General Services (DAGS). Neither HHSC nor individual HHSC Regions incur any indebtedness from CIP projects paid from the general funds of the state. Separate Capital Budgeting Policy (OPN 000x) is provided concerning final year capital requirements at regional and facility levels, both state-funded capital improvement project (CIP) funding and self-funded capital requirements.

Strategic Plan: A document used by an organization to align its organization and budget structure with organizational priorities, missions, and objectives.

General Funds: The general fund is the primary operating fund of the State of Hawaii, used to collect revenues and expend funds throughout departments and agencies of the State. While the vast majority of HHSC revenues and expenses are made through HHSC's special fund, the subsidy from the State of Hawaii to HHSC is made from the general fund to the special fund of HHSC, either as collective bargaining payments on behalf of HHSC or as general funds subsidy made available to HHSC as credits against HHSC's bi-monthly payroll expenditures through the Department of Administration and General Services (DAGS) for HHSC employees.

Special Fund: A fund established to account for special taxes or other revenues required by law or contractual agreement to be used only for specified purposes.

General Funds Subsidy: A subsidy is "Monetary assistance granted by a government to a person or group in support of an enterprise regarded as being in the public interest." While the state of Hawaii is not required by statute nor agreement with HHSC to do so, the recent custom of the Department of Budget & Finance has been to include funding to subsidize the operations of HHSC and the facilities of HHSC in each Executive Biennium Budget submitted to the Hawaii Legislature; and the recent custom of the Hawaii Legislature has been to appropriate a general funds subsidy to HHSC in the biennium budget.

Debt Capacity: The Debt Capacity of an investment or a whole firm is the maximum amount of debt finance, and hence interest payments that it can support without incurring financial distress.

Budget Proviso: A proviso is a clause in a document making a qualification, condition, or restriction. In the Hawaii state budget passed each, provisos may be included that specify conditions or restrictions for expenditures of funds appropriated. For instance, a budget proviso could require HHSC to spend a specified dollar amount of general funds subsidy at a specific facility for a specific purpose, even though that amount and purpose may not have been included in the budget approved and submitted by the region.

III. POLICY & GUIDELINES:

- A. **Executive Biennium Budgets & Executive Supplemental Budgets.** In coordination with Regional System Boards and working with management at regional and system levels, the HHSC Corporate Board of Directors, acting through the board's Finance & Information Systems & Audit Committee (FISAC), will oversee development and issuance of budget instructions and timelines to enable development of facility-level

regional budgets that will be consolidated as the HHSC system budget for submittal as part of either an Executive Biennium Budget or an Executive Supplemental Budget submitted to the Hawaii Legislature.

1. Regional biennium and supplemental budgets will not require approval by the HHSC Board of Directors.
 2. The HHSC Corporate Board of Directors, assisted by senior management, will assist with allocation of general funds guidance among the regions for the purpose of submitting budgets to the Department of Budget & Finance that meet the requirements of the Department. The five regions shall determine and approve methodology for distribution of available general funds for biennium budget submissions and supplemental budget submissions. In years in which regions are unable to come to agreement on distribution of general funds, the HHSC President & CEO will determine methodology for distribution of general funds for the purpose of submitting regional and facility biennium and supplemental budgets. Debt commitments to pay for construction which encumber the real assets of HHSC shall be given priority in the methodology. Prior to final appropriations of funds for the fiscal year concerned, if the five regions come to agreement on alternate methodology for distribution of available general funds, such methodology shall be used for distribution of funds instead of the methodology chosen by the President & CEO for the purpose of submitting regional and facility biennium and supplemental budgets.
 3. Consolidated budget submissions to the Department of Budget & Finance and to the legislature will identify any unresolved disagreements concerning allocation of general funds or other budget issues between a Regional System Board of Directors and the HHSC Corporate Board of Directors, or between one or more Regional System Boards of Directors. Disagreeing comments of the Regional System Board of Directors shall be included in the consolidated budget submission.
 4. Regional budgets for inclusion in Executive Biennium Budgets and Executive Supplemental Budgets will be completed in the fall of each year, approximately nine months before the first day of the fiscal year.
 5. The focus of the Executive Biennium Budgets and the Executive Supplemental Budgets will be development of by-facility and system-level general fund amounts to subsidy operations of HHSC facilities.
- B. Annual Operating and Capital and Cash Flow Budgets.** Additional round of budgeting will be required prior to the start of each fiscal year to finalize details of working operating budgets, capital budgets and cash flow budgets for the fiscal year. It is possible that general funds appropriated will be less than the minimum amounts specified in regional budget submissions, creating a funding shortfall for the forthcoming fiscal year that will begin on the first day of the next month of July. For fiscal years in which regions are unable to come to agreement on distribution of general funds by the time funds are appropriated, the methodology chosen by the HHSC President & CEO for the purpose of submitting regional and facility biennium and supplemental budgets will be utilized to allocate general funds.
- C. Budgeting Systems & Timelines.** In coordination with Regional executives and Regional Systems Boards, the HHSC Corporate Board of Directors may require a budgeting information system for development of common budget formats and terminology to facilitate consolidation of regional budgets for submission through the Department of Budget &

Finance and to the legislature. In the first part of each fiscal year a timeline will be issued for development of Regional budgets for consolidation into the HHSC system budget submission as part of the Executive Biennium Budget or as part of the Executive Supplemental Budget, depending on the year.=

D. Biennium Budget Committees and Supplemental Budget Committees. Working with senior management and regional leaders, the HHSC Corporate Board of Directors and the Regional System Boards will establish the Biennium Budget Management Committee (consisting of the HHSC COO & CFO, the HHSC Corporate Controller and the five Regional CFOs) or the Supplemental Budget Management Committee (consisting of the HHSC COO & CFO, the HHSC Corporate Controller and the five Regional CFOs) each year, depending on the year, to provide direction for the allocation of general funds and development of budget guidance.

1. In the late spring of even numbered years, the **Biennium Budget Management Committee** will be formed to provide direction for the development of regional budgets and the consolidated system budget for submission to the Department of Budget & Finance as part of the Executive Biennium Budget.
2. In the late spring of odd numbered year, the **Supplemental Budget Management Committee** will be formed to provide direction for the development of regional budgets and the consolidated system budget for submission to the Department of Budget & Finance as part of the Executive Supplemental Budget. NOTE: If funding originally appropriated as part of the biennium budget is sufficient, there will be no requirement for HHSC to make a Supplemental Budget submission for the Executive Supplemental Budget. It is anticipated that there will always be additional/supplemental requirements for capital improvements projects (CIP) to submit for consideration for inclusion in the Executive Supplemental Budget.
3. **Corporate Office Budget.** Based on input from the **Biennium Budget Management Committee**, the FISAC will provide guidance to HHSC senior management and regional leaders on the process to develop required support levels at the HHSC corporate office. The Regional System leaders and HHSC Senior Management will determine recommended levels of corporate office support for the biennium budget that will, subsequently, be incorporated into final operating and capital and cash flow budgets submitted to Governance for approval. When approved, the designated levels of corporate office support will remain set for the two fiscal years of the biennium. Corporate office support levels will be reconsidered during the budgeting process for each biennium budget submission.

IV. PROCESS.

A. Executive Biennium Budgets & Executive Supplemental Budgets. Development and submission of best possible biennium and supplemental budgets to the Department of Budget & Finance is an important opportunity to justify fullest appropriate general fund support and CIP funding for the regions and the facilities and the system. The process of developing the biennium and supplemental budget submissions each year also is preparation for development of the final operating and capital and cash flow budgets for the coming fiscal year. The processes for development of operating expenses and revenues projections and capital expense projections, and, in turn, development of cash flow projections to determine general funds required to subsidize system operations, must be based on reasonable assumptions. These efforts may result in development of budgets that project cash flow shortfalls greater than general funds subsidy included in the Executive Biennium Budget or Executive

Supplemental Budget that are greater than the general funds subsidy eventually appropriated in the final budget.

1. Guidance From Department of Budget & Finance. The Department of Budget & Finance issues instructions and timelines for submission of budget information each year, for either the biennium budget or the supplemental budget. For instance, Department of Budget & Finance may advise that no increases in pay and benefits will be included in budgets prepared, because these decisions are made during the collective bargaining process.
2. HHSC Guidance and internal timelines. It is necessary for HHSC to issue budget guidance to supplement guidance from the Department of Budget & Finance, in order for the facilities and regions to develop the detailed projections of revenues and expenses necessary to complete budgets for submission. The **Biennium Budget Management Committee** or the **Supplemental Budget Management Committee** will work with HHSC corporate office staff to development guidance and internal guidelines for each biennium budget submission and for each supplemental budget submission.
 - a. Workload. Guidance on workload for biennium budget submissions and for supplemental budget submissions will be made almost one year before the start of the fiscal year for which the budget is being prepared. Discoveries about overly optimistic workload and revenue assumptions will most likely be made too late in the legislative budget process for increases in general fund support to be included in the budget. The Biennium Budget Management Committee or the Supplemental Budget Management Committee, depending on whether it is a year for biennium budget submission or for supplemental budget submission, will approve guidance on workload. Facilities and regions will have latitude to utilize workload projections that differ from guidance to adjust to local conditions.
 - b. Reimbursements. Guidance for biennium budget submissions and for supplemental budget submissions on reimbursements from Medicaid and Medicare and from commercial payers will be most likely be issued before government payers make final decisions for payments in the fiscal year being funded and before final negotiations with certain commercial payers are finalized. Discoveries about overly optimistic reimbursement/revenue assumptions will most likely be made too late in the legislative budget process for increases in general fund support to be included in the budget. Guidance on reimbursements will be approved by the **Biennium Budget Management Committee** or the **Supplemental Budget Management Committee**, depending on whether it is a year for biennium budget submission or a year for supplemental budget submission. Facilities and regions will have latitude to utilize reimbursements projections that differ from guidance to adjust to local conditions.
 - c. Expense Inflation. Guidance on inflation for several different categories of expenses will be based on standard industry reports and local analysis, as approved by The **Biennium Budget Management Committee** or the **Supplemental Budget Management Committee**. Facilities and regions will have latitude to utilize expense projections that differ from guidance to adjust to local conditions.
 - d. Debt Capacity. To enable regions to develop regional capital budgets and to enable the development of the system level capital budget, the **Biennium Budget Management Committee** or the **Supplemental Budget Management Committee** will develop debt capacity assumptions as guidelines for the regional boards for each region and the system.

- B. **Shortfalls in General Funds.** If amount of general funds subsidy appropriated is less than required to cover projected cash flow shortfalls, emergency funding from the administration or from submission of an emergency appropriation, or both, will be required during the fiscal year, or other source of cash will be required in order for final operating and capital and cash flow budgets to be effective.
 - C. **Corporate Office Budget.** Based on previous decisions made as part of the Executive Biennium Budget process, the Regional System leaders and HHSC Senior Management and staff will determine required levels of corporate office support that will be incorporated into final operating and capital and cash flow budgets.
 - D. **Regional Development of Budgets.** Regional system boards are authorized to issue budget guidelines and timelines for internal development of regional budgets.
- V. **APPLICABILITY:** This policy shall apply to all HHSC regions and facilities and HHSC Corporate staff.
- VI. **REFERENCE:** HRS Chapter 323F
- VII. **EFFECTIVE DATE:** This policy will become effective with the preparation of budgets for the fiscal biennium FB 2009-2011 (Fiscal Year 2010 and Fiscal Year 2011) that begins on July 1, 2009.