

# Kentucky Trustee

For Kentucky Hospital Governing Board Members

Winter 2015

## BOARDROOM BASICS

## Financial Basics for Trustees: Understanding the Fundamentals and Asking the Right Questions

Hospital boards are often overwhelmed with information. But in the wake of understanding the complex changes underway in the health care environment, hospital trustees must maintain a solid understanding of the financial basics, including what to look for, trends, and critical questions to ask. As hospitals move into 2015 and are forced to make difficult decisions due to changing reimbursement and other financial challenges, having a solid understanding of financial fundamentals will arm trustees with the knowledge necessary to make well-informed decisions.

Over the years, Medicare and Medicaid payments have not kept pace with inflation, and hospitals have increasingly experienced financial difficulties. One of the primary objectives of the Affordable Care Act (ACA) is to shift the nation's health care delivery system from one that is paid based on volume (the number of services received/fee-for-service) to a payment system based on value (payment for high quality, cost-effective care). Enactment of new payment systems under the ACA may drive further reductions in revenue if hospitals fail to prevent readmissions, have a high incidence of hospital-acquired conditions, or fail to achieve or improve value-based quality scores.

Trustees must pay close attention to the financial impacts and implications that the forces and trends of transformation may have on their hospitals and health systems. Moody's Investment Services, Standard & Poor's Financial Services LLC and Fitch Ratings are the "Big Three" ratings

agencies. They closely monitor the financial performance of hospitals, frequently issuing financial analyses and projections for the health care field. Ratings agencies and others have projected a financially difficult time for hospitals as the nation's health care system advances through transformation. Hospital boards should be vigilant to the concerns cited by financial experts, engaging in the oversight, discussions and actions necessary to ensure the hospital's or health system's financial stability and sustainability.

Some of the critical concerns cited for not-for-profit hospitals include:

- The annual growth rate of expenses is outpacing the growth rate for revenue;
- Payer mixes are shifting from commercial payers towards government payers;
- Continued reimbursement cuts in Medicare and Medicaid programs;

- Tightening of rate increases by commercial payers;
- An increase in high-deductible plans, shifting greater percentages of costs to patients and thereby increasing bad debt incurred by hospitals;
- Shifts in care delivery from hospitals to outpatient or ambulatory settings;
- Declining patient volumes and increased competition for patients;
- Increased demand for capital investment in information technology and other infrastructure needs; and
- Declines in operating margins and cash flow.

### The Board's Role in Financial Oversight

The board is responsible for the financial success of the hospital, and fulfills a fiduciary responsibility that is defined as a duty of organizational loyalty; a duty of care through application of business judgment; and a duty of obedience in abiding by laws, regulations and standards of hospital operations.

(Continued on page 7)





## PRESIDENT'S NOTEBOOK

**D**uring the holidays we often pause and reflect on what is truly important. At the top of everyone's list is our family, friends and health. In our profession, we are blessed to be able to contribute to the health and wellbeing of others, and it is my distinct honor to share with you the great success Kentucky hospitals have made through their participation in a three year (2010-2013) federal initiative to improve patient safety through the Centers for Medicare and Medicaid's (CMS) Partnership for Patients (PfP).

Nearly all Kentucky hospitals participated in the PfP's Hospital Engagement Network (HEN) during the first two years of the project, whether it was through the Kentucky Hospital Association (KHA) as part of the American Hospital Association's HEN, or through one of the other 25 HENs nationwide. The third year was an "option year" with KHA, and 71 hospitals continued their participation in all eleven target areas that were applicable to their hospital.

The PfP's HEN improvement work provided a vast amount of quality and safety resources to Kentucky. These included evidence-based practice protocols for reducing harm; technical assistance and consultation specific to a hospital's needs and concerns; nationally and locally-renowned subject matter experts; and monthly coaching calls providing the newest information and the opportunity to share and learn from peer hospitals as new processes were implemented.

Due to the great work of the participating hospitals' collective efforts, Kentucky has seen great success in reducing harm and improving quality; thus meeting the goal to reduce overall harm by 40 percent in five areas: early elective deliveries; hospital-acquired pressure ulcers; hospital-acquired falls with injury; hospital-acquired venous thromboembolism (blood clots in the lungs or extremities); and obstetrical harm.

I am pleased to report that, as a result, many Kentucky lives have been saved and injuries have been prevented due to this crucial work. Reducing preventable harm in health care means many things – fewer deaths, less pain, less time away from home, and fewer health care dollars spent. It is hard to place a monetary price tag on what money cannot buy, but to monetize the savings and the effectiveness of the federal initiative, the Kentucky Hospital Engagement Network (K-HEN) prevented and saved:

- 393 falls with serious injury, for a savings of \$260,000;
- 41 Stage 3 and 4 pressure ulcers (bedsores) for savings of \$1.6 million;
- 390 post-operative blood clots to the lungs and/or extremities (VTE) for savings of \$8.7 million;
- 288 obstetrical adverse events, for savings of \$89,000;
- 932 Early Elective Deliveries (elective births prior to 39 weeks with no medical indication), for savings of \$730,000; and
- 26 Central Line Bloodstream infections, for savings of \$442,000.

We know you agree that Kentucky hospitals work tirelessly to provide the highest quality and safest care possible. Please congratulate the clinical teams at your hospital for the work they do every day to save lives and improve their patient outcomes.

On behalf of the entire KHA staff, we thank you for your support and the leadership you provide your community hospital. We look forward to seeing you and the other members of your board next year in Frankfort on February 26 and in Lexington on May 7-8 (please see the side panel). In the meantime, have a safe and joyous holiday season.

Sincerely,



Michael T. Rust, FACHE  
President  
Kentucky Hospital Association



Michael T. Rust  
President

## Governance Notebook

### Save February 26, 2015 for KHA Hospital Day at the Legislature

The Kentucky General Assembly is reconvening in January and, as you know, sometimes bills are proposed which could have unintended consequences detrimental to the operation of local health care facilities. The time you take to educate our elected officials on the current state of health care is vital to protecting Kentucky's hospitals and the outstanding service they provide.

With that said, we invite you to attend the **KHA Hospital Day at the Legislature on February 26, 2015** - it is crucial that your locally elected leaders understand the harmful ramifications that bills may have on Kentucky hospitals and their ability to provide quality health care services. The KHA Hospital Day at the Legislature will be held in conjunction with the KHA Legislative Committee meeting in Frankfort. If you would like to attend, please ask your hospital chief executive officer to contact KHA. Details will be shared in early 2015.

### Follow Hospital Legislation

KHA will be tackling many issues on behalf of hospitals. KHA will seek legislation to **address ongoing issues created by the Medicaid managed care organizations** due in part to the lack of standardization with respect to criteria and procedures. KHA will continue to **support protecting the Medicaid DSH Program to help offset uncompensated care; retaining the current certificate of need program;** the enhancement of legislation establishing **medical screening panels** for the review of all medical liability claims in Kentucky and **oppose any action to increase the amount of provider taxes** hospitals are currently paying. For details about these and other KHA 2015 Legislative Priorities, please visit the "Advocacy" section of the KHA website at [www.kyha.com](http://www.kyha.com).

### Save May 7-8, 2015 for the KHA Annual Convention

As a governing board member, KHA invites you to join your hospital chief executive officer and fellow hospital trustees at **KHA's 86th Annual Convention, May 7-8** at The Lexington Center/Hyatt Regency Hotel. Make plans now to attend. Details will be shared in early 2015.

### Free Trustee Resource: "Critical Questions Every Board Needs to be Able to Answer"

KHA's Kentucky Hospital Research & Education Foundation (KHREF) recently purchased the publication and distribution rights to "Critical Questions Every Board Needs to be Able to Answer." The comprehensive publication was developed by The Walker Company and is a useful tool for governance orientation sessions, and ideal for recruitment and orienting new trustees. It is also a valuable educational resource for more experienced hospital trustees. Please ask your hospital chief executive officer to access it through the "Members Only" portion of the KHA website.

### Do you have ideas for future issues of the Kentucky Trustee?

Our goal is to provide you with the information and knowledge you need to lead your hospitals forward in today's rapidly changing environment. Tell us what you think, and what you would like to see in future issues of the *Kentucky Trustee*.

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## GOVERNANCE INSIGHTS

## Maximizing the Impact: Making the Most of Your Board Retreat

A board retreat is a good way for trustees to brainstorm ideas about the organization's future, strengthen their understanding of the organization's challenges, and develop a sense of teamwork and camaraderie. It is one of the most important leadership efforts governing teams participate in. To be effective, the retreat must be carefully planned, coordinated and executed.

**B**oard retreats should always be planned with a specific purpose and outcomes in mind. For example, *"to involve board members, the administrative team and medical staff leadership in the development of a meaningful long-term vision that will lead the development of strategies for 2015-2020."* Once a clear purpose has been determined, specific action steps may be taken, including seeking out all participants' ideas, viewpoints and perspectives prior to the retreat. This intelligence will help to ensure productive retreat dialogue and discussion. In addition, because a well-planned retreat will typically yield a long list of potential actions to be taken, it's a good idea to conduct a post-retreat follow-up survey to further prioritize potential directions and ideas.

### Intelligence Collection in Advance of the Retreat

Seeking advance viewpoints from board members, senior leaders and medical staff leaders helps the retreat planner and facilitator understand the issues that are

most important to address, and also ensures that participants come to the session prepared to discuss the organization's current strategy, challenges the organization is facing, and critical success factors that must be addressed. Viewpoints should be sought out on specific topics that will be discussed at the retreat. Potential areas of focus in the survey may include:

- Organizational strengths, weaknesses, opportunities and threats;
- Identification of critical issues facing the hospital;
- Actions necessary to be taken to address current challenges and projected future challenges;
- A review of the mission and vision statements, and their applicability to the organization and its environment today and in the future;
- Rating of the organization's existing strategies; and
- Specific objectives to be accomplished as a result of the retreat.

Participants' ideas and opinions may be gathered using a variety of methods, such as a web-based survey, a written survey, personal interviews, small focus groups, or a combination of all four. The broad results of the research should be presented at the beginning of the retreat, setting the stage for a session based on participants' ideas, issues, priorities and needs. The results can also be used as a starting point for discussion about specific issues probed in the survey,

ensuring productive dialogue by giving participants ideas to respond to and build upon.

### Ensuring Productive Retreat Dialogue

The retreat agenda should be developed based on the results of the pre-retreat input. The session should consist of discussion about the issues most important to the organization's board, administrative team and medical staff, and should include prioritization of specific strategies and goals. The dialogue will lead to a list of ideas, goals or initiatives that may be prioritized and finalized following the retreat.

**Breakout Groups.** Depending on the number of critical issues emerging from the pre-retreat research and the number of retreat participants, it may be beneficial to use breakout groups as a way to discuss several issues in more depth. If breakout groups are utilized, a "discussion guide" should be developed to stimulate the groups' thinking and deliberations. The discussion guide should include a list of the topics to be discussed, questions to be answered, and specific outcomes to be achieved from the groups' discussion.

Each breakout group should appoint a moderator to facilitate discussion, as well as a recorder to take notes. Following the discussion, the breakout groups should

(Continued on page 6)

### Ensuring Successful Breakout Discussions

Breakout groups can be an excellent way to encourage broad participation among retreat participants, maximize the use of limited retreat time and develop the greatest number of ideas. To ensure a productive use of time, breakout groups should have:

- A very specific topic to discuss;
- Specific questions to discuss and respond to;
- A facilitator to moderate the discussion and keep conversation on-task; and
- A recorder to take notes for presenting the results to the entire group.



## GOVERNANCE INSIGHTS

## Assessing Your Governance Value in a Transforming Environment

The American Hospital Association has coined the phrase “redefining the H” as hospitals consider what it means to be a hospital in today’s transforming health care environment. In order to be successful in this endeavor, hospital trustees must also redefine their boards, including the board’s roles, responsibilities, and composition. Governance practices and performance assessments are an important starting point boards can take to ensure their boards are well-poised to carry their organizations into the new health care world.

**T**rustees are accountable for ensuring that continuous quality improvement processes are in place throughout their organization. But how do trustees ensure their own continuous quality improvement, and that of the full board? How do they determine when the board is under-performing in relation to the challenges it faces? How can boards of trustees be held to the same level of accountability for quality and improvement to which they hold their organizations?

Through an effective, well-developed governance value assessment process growth opportunities can be realized, education can be pinpointed to unique governance needs, recruitment of new trustees can be undertaken with increased confidence, and long-range planning can be conducted from a consensus-based framework of understanding with everybody on the same page.

A governance value assessment is an organized quantitative and qualitative evaluation of the board’s satisfaction with all aspects of its performance in fulfilling its governance responsibilities. It combines ratings of the hospital’s governance environment, processes, focus and performance, with trustee recommendations for change to improve leadership performance. Done correctly and consistently, a governance assessment process (a combination of the assessment and the action plans created from it) enables the board to identify critical “governance gaps,” and achieve and

maintain the level of governing excellence required for success in today’s transforming health care environment.

### Using the Assessment to Improve Governance Performance

Conducting the assessment is only the first step in improving leadership performance. An excellent governance assessment process does not simply measure trustee viewpoints about governing performance. To be successful it must be a catalyst to engage trustees in a wide-ranging discussion of assessment findings that highlight performance gaps and areas where trustees lack consensus. It must also facilitate the development of a governance improvement action plan.

The assessment should stimulate the board to focus on the key ingredients of leadership success. This enables trustees to discover specific areas of under-performance in comparison to their leadership needs, and pinpoint clearly targeted responses and solutions.

### Assessment Frequency

Ideally, the board should assess its performance annually. Many boards conduct their assessment as part of an annual board retreat, setting aside time to discuss the assessment results and explore ways to improve leadership performance. Some boards are able to successfully design and conduct an assessment, compile and analyze the results and facilitate the

development of a board improvement action plan using internal resources. Others rely on outside consultants who offer tested and proven tools and techniques for governance assessments.

### Conducting the Assessment

The governance assessment may be conducted using a printed survey, an online survey, individual interviews, a facilitated, full board discussion, or some combination of these methods. The assessment should include specific, precise and well-articulated criteria that relate to the hospital’s unique board and leadership challenges. These criteria should be developed by a board development committee or a special governance assessment task force, and should be reviewed and endorsed by the full board as leadership accountabilities they embrace. A meaningful rating scale should be used to rate agreement with the criteria, resulting in measurable, quantifiable findings.



Areas addressed in many assessments include an assessment of overall board performance in several areas of leadership accountability; assessment of committee performance; identification of issues and priorities facing the board; assessment of individual trustee performance, including a peer evaluation; and assessment of the board chair.

Assessment of overall board performance should be divided into several leadership responsibility areas, such as mission,

## Overcoming Assessment Inertia

Experienced assessors offer simple advice: Make the assessment anonymous, measurable and reportable. Use it to identify issues. And don't stop with the evaluation. The most important step is transforming the information gathered through the assessment into knowledge that results in a focused leadership improvement action plan.

- **Focus on critical areas.** Identify the leadership areas that are most critical to focus on to ensure that the board meets its most critical leadership responsibilities.
- **Make the process easy.** Conduct the assessment in a manner that will result in a full response from the board and the best outcomes, including a solid performance improvement plan. For many organizations, this is an online survey. For others, it may be personal interviews, focus groups, or a real-time assessment conducted during a special board meeting. Measurable criteria will help guide the board toward easily identifiable performance improvement areas.
- **Don't make it a one-time exercise.** Governance assessment should be a continuous leadership improvement process. Performance benchmarks should be established using results of the initial assessment, and a board performance improvement plan with specific activities, responsibilities, timeframes and projected outcomes should be assembled.

Whatever you do well at the board level cascades throughout the organization. Governance assessments, when done right, can have profound implications throughout the organization.

values and vision, strategic direction, quality and patient safety, community relationships, financial leadership, and relationships with the CEO and medical staff.

**Rating Committee Performance.** The committee performance evaluation asks trustees to rate criteria specific to the charter and goals of each committee. The committee evaluation may also ask trustees to provide additional ideas for ways each committee can improve its leadership performance.

**Major Issues and Priorities.** In addition to rating the board's performance using a quantifiable rating scale, the assessment should also provide trustees with an opportunity to answer several open-ended questions. Open-ended questions give trustees an opportunity to share their opinions about the highest priorities for the next year, and governance strengths and weaknesses. The assessment may also ask about significant trends the hospital should be addressing and preparing for, and the most critical challenges or issues the board should address.

## Personal Performance Assessment

An individual performance assessment is a critical piece of a quality governance assessment process. Trustees may have

one view of the overall board's performance, and have an entirely different view of their own individual performance or that of their colleagues. A personal, introspective look at individual leadership enables trustees to focus on the essentials of good leadership and their personal impressions of their individual performance.

A good way to evaluate personal governing performance is through a peer assessment. This enables trustees to personally evaluate their performance, and the performance of each of their board colleagues, using a short list of relevant criteria.

Trustees should rate themselves and their colleagues in two broad areas: 1) governing attributes, the factors that define their performance in fulfilling their governance duties; and 2) personal competencies and attributes, the factors that describe the personal strengths and abilities required for effective trusteeship.

In addition, each trustee should answer one simple question after rating each individual board member: "What suggestions do you have for ways this trustee colleague can improve his or her governing performance?"

The process provides trustees with unique insights into their leadership attributes and

needs from the informed perspective of their trustee colleagues.

## Taking the Next Step: Using Your Assessment Results to Improve Board Effectiveness

Conducting the governance assessment is just the first step in improving governance leadership performance. The key to success of the full process is not simply the measurement of trustee viewpoints, but is instead the action that is taken as a result of a careful examination of trustee viewpoints.

The assessment results should be a catalyst to engage trustees in a wide-ranging discussion of findings that highlight performance gaps and areas where trustees lack consensus about the board's performance.

A full review of the results should stimulate the board to discuss their opinions and ideas for improving board success, and result in the development of a governance improvement action plan with clearly defined responsibilities, time frames and projected outcomes. Boards should then monitor their progress to ensure that projected outcomes are achieved, and revise the governance improvement action plan when necessary.

## Quick Test of Your Governance Assessment Process

- ✓ Do you conduct a governance assessment annually?
- ✓ Does your full board participate in the assessment process?
- ✓ Do you conduct a personal performance assessment?
- ✓ Is your assessment anonymous, allowing trustees to freely and candidly express their opinions and ideas for governance change?
- ✓ Does the full board review the results of the assessment, discuss their interpretation of the findings, and determine potential areas for necessary board improvement?
- ✓ Do you use the assessment results to develop actionable and measurable plans for governance improvement?
- ✓ Does your board monitor progress of improvement initiatives?



(Continued from page 3)

convene together for the moderators' reports, full group discussion and specific recommendations.

**Prioritization of Critical Issues, Goals or Strategies.** Full group or breakout discussions may result in a long list of key issues facing the organization, and several potential strategies to address these issues. In order to focus the organization's attention on the most critical issues and strategies, the ideas must be prioritized. Prioritization can be done in several ways, using either "low-tech" or "high-tech" alternatives.

- A "high tech" option is to utilize an electronic voting system. Each participant uses a wireless keypad to respond to questions presented on a screen, using specialized software integrated into PowerPoint. Participants can rate and rank ideas, and immediately see the results of their anonymous input.
- A "low-tech" option is to list the ideas, issues, goals or strategies identified on flip charts and post them around the room. Each retreat participant is given an equal number of colored stickers, which they place next to the items they believe are most important. As an alternative, participants may simply place a specified number of check marks next to the items they believe have the highest value or the greatest priority.

Both the "high-tech" and "low-tech" options give everyone an opportunity to share their opinions and stimulate dialogue, and result in an immediate understanding of participants' views.

### Retreat Evaluation: How Did You Do?

Conducting a retreat evaluation at the conclusion of the session encourages participants to share their opinions about the effectiveness of the meeting, and provides valuable feedback essential to improving subsequent retreats. A typical retreat evaluation may ask participants to rate specific components of the retreat, such as overall organization and flow of the retreat, the value of the pre-retreat

## Sample Pre-Retreat Survey Questions

### SWOT Analysis

- What are the organization's three greatest strengths? What can we do to best maximize these strengths?
- What are the organization's three most significant weaknesses? What can we do to minimize or eliminate these weaknesses?
- What are the three greatest opportunities that the organization may be able to capitalize on (e.g. community relationships, partnerships, information technology, service expansion, etc.)? What can we do to successfully capitalize on these opportunities?
- What are the three most significant threats facing the hospital (e.g. reimbursement, regulation, competition, workforce shortages, etc.)? What can we do to eliminate these threats?

### Critical Issues

- Rank the importance of critical issues, such as quality transparency, enhancing information technology, physician relationships, forging new partnerships, price transparency, etc.
- What other issues must be considered? What is the greatest challenge to the organization's future growth and competitiveness?

### Forces for Change

- Indicate how critical forces are for ensuring future success of the organization, such as attracting a qualified workforce, being well-positioned in the market, clearly demonstrating community benefit, ensuring access to capital, etc.
- What else is critical for the organization to understand and effectively deal with?

### Mission and Vision

- Will our mission and vision continue to be appropriate and viable in the years ahead? If not, how do you believe the mission and vision should be different?

### Strategic Success

- Indicate how successful the organization has been to-date in achieving its objectives (rate each strategic objective individually).
- Do you believe the successful achievement of these strategies will result in attainment of our mission and vision? If not, what do you believe is missing?

### The Retreat

- What do you most want to accomplish at the retreat?

research, overall participation and interaction, the quality of discussion and dialogue, and the success of the retreat in helping define the organization's goals and strategies. The retreat evaluation may also ask a few open-ended questions, like what was the most beneficial outcome of the retreat, and other ideas participants have for future retreats. When applicable, the evaluation may also ask about satisfaction with the retreat location and amenities.

### Retreat Follow-Up

When critical issues and strategies are discussed and prioritized at the retreat, a brief follow-up survey can help to further clarify participants' opinions and create a roadmap for next steps. For example, the ten most critical strategic issues may be identified at the retreat, and a broad range of ideas for strategies and objectives to

address those issues may be developed. But deeper analysis may need to be conducted, such as determining the implications of the issues, the urgency of strategy implementation, resources required, etc. By completing a follow-up survey following the retreat, participants are able to share their opinions in a deliberative, thoughtful manner.

The retreat process wraps up with a post-retreat meeting to review the results of the follow-up survey, and take official action on the retreat outcomes, if required. This may be a regular board meeting or an extension of a regular board meeting. If desired, based on the scope of the survey results, a special board meeting may be required with a sole agenda item to discuss the survey findings and determine board action.

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Boards have a broad responsibility to protect the limited resources of the hospital to ensure optimum services and benefit to the community. The board must ensure the cost-effective utilization of resources and the establishment of both long-range and short-range financial plans. The board should regularly review meaningful and understandable financial reports, ensure that adequate capital is available for the hospital's investment strategies, and actively participate in and encourage regular philanthropic efforts.

**Protecting Financial Status.** One of the most critical functions of the governing board is protecting the hospital's financial status. The board should monitor financial goals in a variety of key areas including growth, debt capacity, return on equity and other areas that define financial success. The board approves the annual operating and capital budgets, receives and approves a variety of budget reports throughout the year, primarily through a finance committee, and oversees the hospital's investment policies and goals.

In addition, boards of trustees are typically involved in assessing the impact of the hospital's pricing strategies and discount policies, and become involved in discussing and approving contractual arrangements and other determinants of financial performance. Boards also determine policy on uncompensated care, provision of needed community services that may not be financially viable, and development of diversified revenue streams.

**Compliance.** A key board responsibility is determining the hospital's financial goals and monitoring its operations to ensure the attainment of those goals. The annual budget is the primary vehicle for the board and administration to establish financial objectives. Board members must clearly understand the assumptions upon which the budget is based. Budget assumptions should be reasonable and clearly

understood, and should tie directly to service development and to the hospitals mission, vision and strategies.

The governing board also has a responsibility to engage external auditors to perform an annual audit of the hospital's financial records. This audit helps the board determine if the financial position and operations are accurately and fairly presented, and are in accordance with generally accepted accounting principles. The board should use the audited financial statements to determine whether the hospital is reaching its established financial and operational targets; it should be a tool in helping to determine progress and assess whether goals and strategies require modification.

The board's financial planning direction and decisions should flow out of the hospital's long-range strategic planning initiatives. Studies of the financial feasibility of new programs or capital acquisitions should be regularly performed and reported to the board. The board should then use financial performance against budget and compare to peer groups as a tool for gauging organizational progress and effectiveness.

**A key board responsibility is determining the hospital's financial goals and monitoring its operations to ensure the attainment of those goals.**

### Financial Basics

As a general overview, there are three basic statements that board members should review. These statements, the Balance Sheet, Statement of Operations and the Statement of Cash Flows, should be reviewed together, rather than on a stand-alone basis, since they are interrelated. Problems that might be masked by looking at one or two statements become easier to identify when examining all three together.

**The Balance Sheet.** The balance sheet lists the assets, liabilities, and equity of the hospital. It also classifies those assets which are expected to be turned into cash within one year (identified as "current assets"), and those debts which are going

### Key Financial Questions for Boards to Consider

When reviewing the hospital's finances, the board should know answers to questions such as:

- What is our payer mix? How is it changing?
- How has/will health care reform and the subsequent payment incentives impact our financial viability?
- What are our major investments, and are they financially sound?
- What are the major drivers behind changes in our key financial metrics?
- What are the organization's financial projections for the future, and what assumptions were used?
- Does the board have a sufficient financial understanding to review and analyze financial statements, trends and projections and identify warning signs and the potential need for a change in the organization's course?

to be due for payment to the lender within one year (identified as "current liabilities").

**The Statement of Operations.** The statement of operations (or "income statement") identifies the sources and amounts of revenue after they have been adjusted for contractual allowances, as well as the operational and non-operational expenses of the organization. It provides the reader with the "bottom line" of the organization, from both an operating and non-operating basis.

**The Statement of Cash Flows.** The statement of cash flows is often the statement that provides the most confusion in financial statement analysis. This is unfortunate, since it can in certain circumstances be the most important statement reviewed. The statement of cash flows identifies the sources and uses of cash. It attempts to explain to the reader where the cash is coming from, and what it is being used for.

**Looking at Statements Together.** What is your organization's cash balance? What is that cash being used for? Is there a declining balance? Are large payments due to be paid on debt that will reduce the

(Continued on page 8)

(Continued from page 7)

amount of cash further, which may strain the organization? How can you find the answers to these questions?

These questions can be answered by looking at the statement of cash flows and the balance sheet. The balance sheet lists the cash balance as the first item. On comparative statements (statements with balance information from prior periods listed for comparative purposes next to the current information) you can see if the cash has increased or decreased since that time. But the most important question to ask is what is causing the cash balance to go up or down. This can be answered by reviewing the statement of cash flows. This statement tells the reader where the cash is coming from and where it is going. For example, if the source of the increase or decrease in cash is from the operations of the organization, then there will be an increase or decrease in the line “Net increase (decrease) in cash from operating activities.” If the source of the increase or decrease is from purchases or sales of fixed assets or from purchases or sales of investments of the organization, there will be an increase or decrease in the line “Net increase (decrease) in cash from investing activities.”

The question to ask is “why is our cash balance increasing or decreasing?” Just because a hospital has more or less cash than it had in the prior month is not necessarily a cause for alarm. The reasons are many and varied, and may be good or bad. Did you refinance or incur new debt? Did you make a large debt payment? Is



operations using cash, or providing cash to the organization? Did you purchase fixed assets or property?

Another question to ask related to cash is “what is our cash balance anticipated to be in the future?” Do we have any large debt payments or other obligations that we are going to be required to pay in the near future? This can be answered by looking at the balance sheet and seeing if the current liabilities are large, or if they have increased over the prior comparative balances.

**Understanding the Key Components.** Trustees must understand the basics of accounts receivable and revenue, and how they relate to contractual arrangements with payers. They should monitor the organization’s investments and its

## Recent Payment Changes: What the Board Needs to Know

**Bundled Payments.** The “Bundled Payments for Care Improvement Initiative” was rolled out by the Centers for Medicare and Medicaid Services (CMS) under the requirements of the ACA. Designed to improve quality and control costs, a bundled payment is one single payment for multiple services received by a patient from one or more providers during an “episode of care.” This shift will require greater hospital/medical staff alignment, shared information and data (electronic health records), and a strengthened infrastructure to manage and disperse payments. It is also prompting some organizations to approach payer relationships differently.

**Hospital-Acquired Conditions.** CMS stopped paying for certain Hospital-Acquired Conditions (HACs) in 2008, and began publishing HAC performance on the *Hospital Compare* website in 2011. Beginning in FY2015, under the ACA, Medicare payments to hospitals in the lowest-performing quartile for HACs will be reduced by one percent. This payment reduction applies to all Medicare discharges.

**Readmissions.** Beginning in FY 2013, CMS reduced its payments to hospitals with “high rates” of readmissions in an effort to improve quality and reduce costs. Whether a hospital’s payment is cut depends on how well the hospital controls its preventable readmissions. The reduction, which applies across all discharges, was limited to one percent in FY 2013, and increased to two percent in FY 2014 and three percent in FY 2015 and thereafter. Hospitals with high readmission rates may participate in a voluntary program with a patient-safety organization (PSO), and will need to implement improvement plans.

**Value-Based Purchasing.** Value-Based Purchasing (VBP) is payment for actual performance vs. payment for just reporting hospital performance. Under VBP, CMS will keep between one and two percent of hospitals’ payments – and hospitals will have a chance to earn back the withhold depending on the quality of their care. CMS began withholding a percentage of Inpatient Prospective Payment System (IPPS) hospital operating payments in FY 2013 at one percent, increasing the amount 0.25 percent annually up to two percent in 2017. CMS estimates that the 1.5 percent withhold for FY 2015 represents \$1.4 billion. Hospitals have a chance to earn back some or all of this withhold, either by achieving high-level quality scores on specified measures or, if a hospital’s performance is not at achievement levels yet, by improving its quality performance.

liabilities, and should understand both current and long term debt. While these components may be “second nature” to the leadership team, board members should not be shy in asking clarifying questions. Often asking a question that seems straight forward may lead to greater clarity and lively discussion for all board members, improving future financial understanding and laying a solid foundation for evidenced-based decision making.

## Sources and More Information

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