

Hospital Focus

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The Governance Institute

Enhancing Financial Oversight for Independent Hospitals

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In The Governance Institute's biennial survey, independent hospital boards consistently rate financial oversight as the area, of all board functions, where they perform best.¹ The 2023 survey found 99 percent of independent hospital board members responded that their board's overall performance in fulfilling its responsibility for financial oversight was good, very good, or excellent. Exceptionally high ratings were provided for reviewing and discussing financial plans and budgets and for evaluating the financial feasibility of major projects before approving them.

Among the lower-scored questions regarding financial oversight, however, were whether the board monitors financial performance against board-established targets related to liquidity ratios, profitability, and debt, and whether it demands corrective action in response to underperformance.

Especially imperative—while many independent hospitals are experiencing financial stress at levels not recently experienced—is having a clear understanding and oversight of financial performance and the impact on key financial ratios of major initiatives.

Independent hospitals should consider strengthening their oversight by establishing or enhancing a financial oversight committee, regularly reporting and discussing key financial health metrics, and ensuring the financial implications of major initiatives are fully vetted, tracked, and monitored.

1 Kathryn Peisert and Kayla Wagner, *Think Bold: Looking Forward with a Fresh Governance Mindset*, The Governance Institute's 2023 Biennial Survey of Hospitals and Healthcare Systems.

Establishing or Enhancing a Financial Oversight Committee

Most hospital boards have a finance committee. If yours does not, chartering one is a foundational step toward ensuring your board provides appropriate oversight and attention toward the hospital's financial health. Once established, the effectiveness of the finance committee can be enhanced. To do so, boards should:

- **Diversify perspectives and skills.** Your finance committee should include not only board members with adequate financial acumen to critically review financial statements, recommend financial policies, and monitor performance but also members with substantial healthcare experience. Physician participation is particularly valuable to evaluate the effect of financial decisions on patient care and identify alternatives that may not be apparent to members without a clinical perspective.
- **Provide continual education and training.** The entire board should receive training in healthcare finance to maintain an understanding of best practices; financial and operating levers; national, regional, and local trends; changes in reimbursement; and critical realities driving the system's current performance. The finance committee will need to receive additional training so it can drive discussions that clarify the financial implications and risks related to decisions the board is facing, challenge your chief financial officer, bring ideas for financial improvement to the board and executive team, and encourage transparent accountability.
- **Prioritize and balance how the finance committee spends its time.** Focus on snapshots of current performance along with long-term financial planning, capital investments, and risk management. The committee should be well informed of strategic issues that will affect financial performance many years from now.

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Key Board Takeaway

The most effective finance committees include clinical board members with patient care experience and perspectives.

Reporting and Discussing Key Financial Health Metrics

Hospital boards should routinely review detailed financial statements, analyze variance of actual financial performance against the budget, determine and understand the root cause(s) of any negative variance(s), and monitor financial health key performance

indicators. It is the board's responsibility to ensure that the hospital's financial reporting procedures are comprehensive and transparent. Boards should:

- Begin their review and oversight of financial metrics with the measures of profitability (e.g., operating margin), liquidity (e.g., cash flow coverage ratio), solvency (e.g., debt-to-capital ratio), and efficiency (e.g., length of stay) used by credit rating agencies. Targets should be set and trends should be discussed.
- Include detailed review and analysis of operational metrics that provide early warning signs for financial performance. For example, fluctuations in market share, medical group visits, ancillary services, and payer mix can indicate future revenue changes. Variations in FTEs per adjusted patient day, cost per adjusted admission, and resource utilization rates can provide advanced notice of expense changes. Understanding key operating indicators and their impact on overall financial health is paramount.
- Implement financial management systems that allow reporting and tracking of metrics, predictive analytics, and comprehensive dashboards that are designed for ease of use.

Key Board Takeaway

Financial distress usually comes slowly, with many warning signs for those who know where to look.

Vetting the Financial Implications of Major Initiatives

The degree of diligence used by hospital boards to evaluate the financial implications of major initiatives varies substantially. When reviewing and approving initiatives, high-performing boards require detailed information regarding the initiative's strategic alignment with the hospital's mission, vision, and goals; legal and regulatory compliance; operational impact; and financial impact. When vetting the financial implications of major initiatives, hospital boards should:

- Require a clear and consistent review of the financial feasibility. It is critical for the board to receive financial projections with sensitivity analyses, funding sources, impact on financial metrics, and return on investment.
- Assess the potential financial risks associated with the initiative and discuss mitigation strategies.
- Engage external advisers, when needed, to ensure the assumptions and resulting financial projections are realistic, and the board can confidently rely on them to make decisions.

Key Board Takeaway

Hospitals should use standard financial templates for major initiatives and capital plans, with summary reports that can be used to obtain board approval.

Maintaining Financial Awareness

A hospital board's duty of care requires effective oversight of the hospital's financial health and sustainability. Oversight should never be confused with management; however, board members should ensure the hospital is making the best use of its assets by participating in discussions, confirming adequate analysis is performed, and making sound decisions. By establishing a highly functioning financial oversight committee, requiring regular reporting and discussion of key financial health metrics, and ensuring the financial implications of major initiatives are fully vetted, hospital boards will be better positioned to support their hospital's financial resilience and sustainability.

Questions for the Board

- Are we positioned to have an effective finance oversight committee, given our current governance structure?
- Do we have potential finance oversight committee members with the requisite perspective, skills, and background to be effective?
- How will the overall board interface with a finance committee, and what controls exist between the two?
- To approve all capital projects of a certain size, should we require a standard report that provides financial projections and metrics?

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