The Board's Role in Capital Resource Allocation

By Jason H. Sussman, Kaufman, Hall & Associates, LLC

High-performing organizations typically have clear delineation and balance between governance and management responsibilities and accountabilities, thereby enabling both parties to focus on the challenging work at hand in the rapidly changing healthcare environment.

For more than a decade, board members of hospitals and health systems nationwide have consistently placed "financial oversight" at the top of the list of board fiduciary duties and core responsibilities (see **Exhibit 1**). More than 96 percent of board members surveyed in The Governance Institute's Biennial Survey of Hospitals and Healthcare Systems cite within this duty adoption of four recommended financial oversight practices related to capital allocation and management at the organization:

1. The board approves the organization's strategic capital and financial plans.
2. The board reviews information at least quarterly as to the organization's financial performance against the approved plans.
3. The board demands corrective actions in response to under-performance on capital and financial plans.
4. The board requires that the organization's strategic and financial plans be aligned.

Despite clarity provided by use of the words *the board approves* in #1 above, the delineation of responsibilities related to capital decision making often remains murky, misunderstood, or misapplied. This introduces significant risk to the organization given the fact that long-term success in the current dynamic environment depends highly on the quality of today's investment decisions.

Overseer or Decision Maker?

The Governance Institute and Kaufman Hall hold that the capital allocation and management process is a *management* responsibility. The optimal role of the board should be to provide appropriate *oversight* of the process, rather than directly evaluating specific allocation options and making related spending decisions. (See sidebar "The Board's Role in Capital Allocation and Management" for more information on The Governance Institute's position.)

Board oversight of the capital allocation and management process should occur at numerous points as the process intersects with the organization's strategic-financial planning process, as illustrated in **Exhibit 2** on the next page.

But what are these points, and what should a board be looking for at each juncture? What questions should the board ask its management team to ensure that capital allocation and management is fully integrated with the overall planning process, and thereby yielding the best decisions?

Board oversight of management decisions related to capital allocation should begin with quantification of the amount of cash flow available for capital spending, and end with review of the projected performance of approved capital spending plans. This article provides a description of the eight oversight points and the questions[1] boards should be raising at each stage.

Key Board Takeaways

The board's primary responsibility is to ensure alignment of the capital allocation and management process to the long-range strategic, financial, and related operating plans. The board should understand that the capital allocation and management process is a *management* responsibility. The optimal role of the board should be to provide appropriate *oversight* by asking management important questions as the process intersects at various points with the organization's strategic-financial planning process. The board should:

- Ensure that management allocates capital as part of a *single batch* process, viewing capital as a portfolio of investments, whether it is destined for new digital ventures or other traditional types of capital-based initiatives.
- Be alert to, and work to eliminate, management tolerance of "end-arounds" (i.e., project evaluation and spending approvals that occur *outside* of the structured process).
- Ensure that large projects, particularly those with associated debt, divestitures of material assets, and creation of a new corporation or joint venture, require board approval before they are initiated based on business-case revalidation.
- Have and foster an understanding that not all projects for which capital is allocated will be successful. As such, all individual project proposals should incorporate exit strategies.

Exhibit 1. Overall Performance Ranked by Average Score

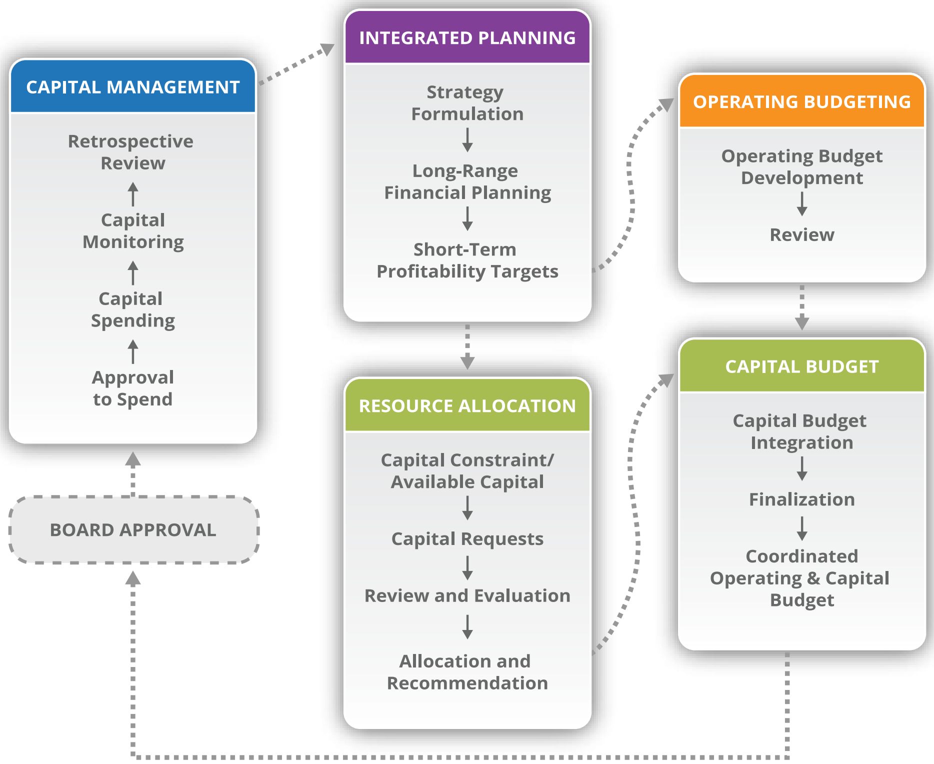
Duties/Responsibilities	2003	2005	2007	2009	2011	2013	2015*
Financial Oversight	1	1	1	1	1	1	1
Duty of Care	2	2	2	2	2	2	2
Duty of Loyalty	3	3	3	3	3	3	3
Quality Oversight	6	6	5	6	4	5	4
Duty of Obedience	7	4	6	5	5	4	5
Management Oversight	5	5	4	4	6	6	6
Strategic Direction	4	7	7	7	7	7	7
Community Benefit & Advocacy	9	9	9	9	8	8	8
Board Development	8	8	8	8	9	9	9

*Most recent year data is available.

Source: The Governance Institute's Biennial Surveys of Hospitals and Healthcare Systems, San Diego, California, 2003–2015.

1 The repetition of questions across multiple sections purposefully guides board members to critical areas of focus related to evaluation of management's decision-making process.

Exhibit 2. The Integrated Planning Process



Source: Kaufman, Hall & Associates, LLC

The Board's Role in Capital Allocation and Management

Whether local or system-wide, boards have fiduciary responsibility to protect and enhance their organizations' financial resources. They must provide oversight that ensures that these resources are used for legitimate purposes and in legitimate ways. The Governance Institute has identified specific practices that are part of a board's core strategic and financial responsibilities. Practices that affect capital allocation and management include the following:

- Articulating a vision and mission for the organization
- Overseeing organizational strategy and strategic planning, which involves review, approval, and monitoring of progress toward specified goals
- Ensuring alignment and integration of all plans (financial, capital, operational, quality improvement, and more) with the organization's overall strategic plan/direction
- Establishing key financial objectives that relate to goals and mission
- Overseeing the thorough and timely development and implementation of capital and operating budgets so that resources are allocated and managed effectively across competing uses
- Ensuring levels of financial performance that support strategic investment and meet established credit goals
- Approving the organization's capital and financial plans and reviewing information on the organization's performance against those plans
- Ensuring prudent investment of excess funds and access to debt and other capital sources

Sources: Kathryn C. Peisert, *Governing the Value Journey: A Profile of Structure, Culture, and Practices of Boards in Transition,* The Governance Institute's 2013 Biennial Survey of Hospitals and Healthcare Systems; and Kathryn C. Peisert, *21st-Century Care Delivery: Governing in the New Healthcare Industry,* The Governance Institute's 2015 Biennial Survey of Hospitals and Healthcare Systems.

Oversight Point 1: Definition of the Capital Constraint

The *capital constraint* defines the cash flow an organization can afford to spend on capital. It represents net cash flow available for project and annual capital spending in the context of a multi-year period, typically three to five years, as defined by the organization's strategic financial plan. In defining the capital constraint, management should answer the question:

- What amount of capital capacity, generated both by internal operations and through external sources, will be available to support the organization's growth and development over the defined period of time?

The capital constraint calculation should account for all sources and uses of cash (see **Exhibit 3** on the next page). The formula adds all sources of cash on the left side of the graphic, and then subtracts all uses of cash on the right side of the graphic, to determine *total cash available for capital spending*. Contingencies are subtracted from this sum to yield *net cash available for capital allocation,* or the *capital constraint.*

The board's oversight responsibility should focus on whether management's capital constraint calculation is tied directly to the short- and long-term performance targets in the long-range financial plan. The board's key questions, therefore, are:

- Does capital availability, as defined by management, reflect comprehensive organizational cash flows (i.e., cash sources)?
- Is the level of capital spending (i.e., the capital constraint) appropriate, given the organization's strategic financial plan?
- Is the calculated capital constraint consistent with the planned performance in year one of the financial plan?
- What is the process for ensuring that major acquisitions/initiatives are included in both the capital allocation process and the organization's long-range strategic and financial plan?

Without a multi-year strategic financial plan, an organization will be unable to establish objective levels of capital spending for the upcoming years and to assess the impacts of its decisions on future years.

Exhibit 3. Sources and Uses Portion of the Capital Constraint

Sources of Cash	Uses of Cash
Net income plus depreciation	Principal payments
New financing proceeds	External transfers
Existing bond-related construction funds	Carry-forward project capital
Cash reserve spend-down	Contingency set-asides
Working capital release	Balance sheet cash reserves
Philanthropy (donor restricted)	Working capital funding

Source: Kaufman, Hall & Associates, LLC

Management should allocate capital as part of a *single batch* process, whether the capital is destined for new digital ventures or other traditional types of capital-based initiatives (see sidebar "Investment Types That Should Be Covered by the Capital Allocation and Management Process"). All proposed expenditures that meet the broad definition of threshold capital dollar levels, as described next, should be subject to the capital constraint and included in the management review process.

Investment Types That Should Be Covered by the Capital Allocation and Management Process

Given the evolving nature of healthcare strategies, a current, best-practice capital allocation and management process should include the following types of capital:

- Facilities, property, and equipment, including information technology
- Business acquisitions and partnerships
- Divestitures and asset monetization
- Equity investments
- Network development
- Managed care (health plan) investments
- Digital/telehealth investments
- Leases for ambulatory and other facilities
- New operating entities, programs, and services (e.g., ambulatory and post-acute services and facilities)
- Program start-up/expansion subsidies
- Physician practice acquisition investments and integration subsidies

Source: Kaufman, Hall & Associates, LLC

The board should be alert to management tolerance of "end-arounds" (i.e., project evaluation and spending approvals that occur *outside* of the structured process). A simple question will illuminate the commitment of the management team to the discipline of a controlled allocation process:

- How does management handle requests for capital made to individual executives or departments?

The answer should be: No requests are permitted other than as part of the centralized, structured decision-making process.

Oversight Point 2: Resource Allocation Objectives and a Portfolio Approach

The board must be assured that the allocation process is structured with unambiguous objectives—meaning they are specific, measurable, and closely intertwined with the integrated decision-making framework.

At the highest level, an organization's objectives for the process design should be to achieve consistency, standardization, reliance on analytics, known timing, accountability, integration with the integrated planning process, and transparency of management decision making.

The board's primary responsibility is to ensure alignment of the capital allocation and management process to the long-range strategic, financial, and related operating plans, as described in detail in Oversight Point 6. Key questions are:

- Is the process structured—as in Exhibit 2—to support such alignment?
- How are investment priorities determined and related to the strategic plan?
- How are allocation decisions integrated with the multi-year financial plan and annual budget?

Board members should look for best-practice structures in their organizations' capital allocation and management process. Among these, a portfolio approach to allocation should be a primary focus. To be effective in its governance of the decision-making process, the board should be reviewing for approval, on an annual basis, the complete portfolio of investments proposed by management for the coming year. So the question is:

- Is a portfolio approach to spending occurring in the organization?

As part of the portfolio view, the board should be able to determine how the portfolio and the individual initiatives within that portfolio will add measurable financial and strategic value to the organization. The alternative, reviewing individual projects throughout the year, does *not* provide the board with a sense for how each project is advancing organizational strategy, or how all projects come together to create an optimal investment portfolio with an overall positive return.

Oversight Point 3: Use of Capital Pools

Following a definition of capital available for spending and a commitment to a portfolio approach to allocation, the next point of board contact is oversight of the management team's use of investment pools to differentiate types of spending. The key question boards can raise is:

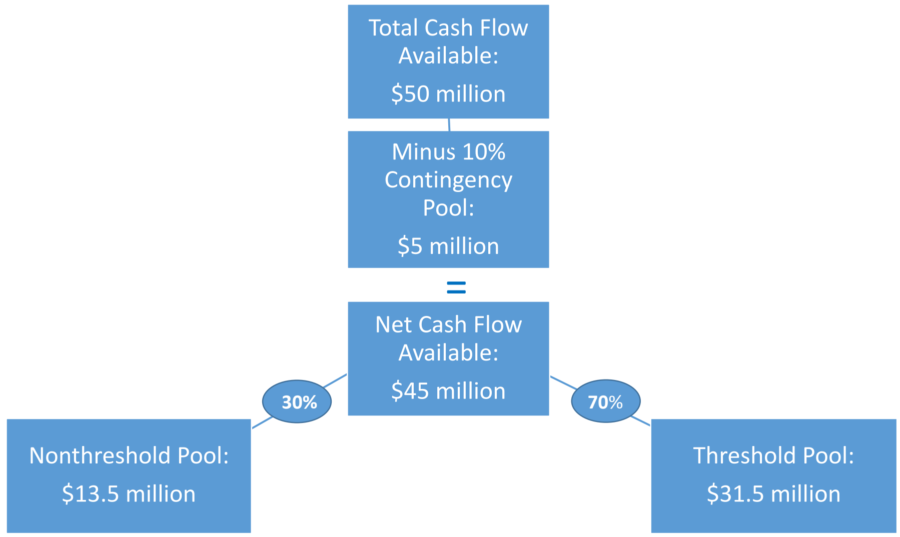
- Are there capital allocation pools and if so, how are these pools defined, accessed, and managed?

Capital pool designations vary widely among healthcare organizations, but should be present in all organizations. Pools are *not* predefined buckets of defined dollars for various purposes. Rather, a well-designed capital allocation and management process has three investment pools defined as follows:

- The *nonthreshold capital pool* consists of requests that fall *under a threshold* dollar amount, explicitly defined, and therefore do not require detailed

business planning or central review and management. Boards should not be involved in the approval of items in this pool or the pool as a whole.
- The *threshold capital pool* consists of requests that are *at or above* the specific threshold dollar amount defined by an organization. Comprehensive business planning analysis and central review are required for these requests, which typically comprise 70–80 percent of net cash flow available capital for spending.
- The *contingency capital pool* is intended to support threshold capital needs and should be managed centrally as a safety valve to cover cost overruns, emergency needs, and preplanning costs. It typically is set to be about 10 percent of total capital available for spending.

Exhibit 4. Funding the Threshold and Nonthreshold Pools



Source: Kaufman, Hall & Associates, LLC

For example, a two-hospital health system with a capital constraint of $50 million might set the *threshold* dollar amount at $250,000 based on the fact that 68 percent of current and past requests have been for $250,000 or more. After allocating 10 percent to a contingency pool, the threshold pool receives 70 percent of net cash flow available capital and the nonthreshold pool receives 30 percent. Therefore, the pool available to high-dollar threshold initiatives is $31.5 million (see **Exhibit 4**).

Each threshold capital initiative should have been evaluated by management based on an associated business plan that describes the business or investment concept and its financial effect in significant detail. The plan must provide the basic documentation and analysis necessary for management to make a valid capital decision. The sidebar "Core Elements of Comprehensive Business Planning" outlines the elements vital to business planning.

Oversight Point 4: Evaluation of High-Dollar Requests

Management of threshold capital should be under the aegis of a central capital management council or team (hereafter "council"), whose members represent key management team members and organizational constituencies (see **Exhibit 5**).

As mentioned, the threshold level is set at a dollar level that generally reflects a dollar level that will cover 70 to 80 percent of the current capital constraint, based on historical proportions and current requests. Because these are high-dollar spending requests, each will require consistent, transparent, and rigorous quantitative analysis that enables comparative evaluation and assessment of the initiatives individually and of the portfolio of requests as a whole.

While the specifics of threshold capital evaluation are part of the management-defined allocation process, board members can use the following questions to assess the appropriateness of the threshold capital evaluation/allocation process vis-à-vis the organization's broader strategic and financial requirements:
- What process does management use to review and evaluate high-dollar capital requests?
- What details are expected in a business plan for these threshold capital initiatives?
- What hurdle rate is required for return on investment?
- How does the decision-making process assess the risk of not meeting targeted performance rates?

With high-dollar, threshold requests, the board needs to know that management is applying uniform criteria in a formal *single batch review process* for investment opportunities that are consistent with organizational strategy. Use of standardized business plans and capital project review forms and templates facilitate informed decision making. Information required of all proposed threshold capital initiatives should have the following components:
- Description of the initiative and its alignment with the organization's mission and strategic plan
- Details supporting the level of investment required to start and complete the initiative, including the amount and timing of required capital investment, and projections of initial and ongoing operating requirements
- Detailed quantitative analysis to identify potential return on

Core Elements of Comprehensive Business Planning

- Definition of the proposed business/investment and the specific strategic objectives it will address
- Quantification of the capital resources required to initiate, complete, and maintain the proposed investment
- Delineation of the potential population to be served and the means by which that population's health or care needs will be enhanced by the investment
- Projection of the initial and ongoing operating requirements associated with the proposed investment
- Calculation of the potential return on investment, including analysis and quantification of key risks associated with the investment
- Identification of potential exit strategies and related performance measures

Exhibit 5. Sample Capital Management Council Structure

Voting Members	Nonvoting Staff Support
Chief executive officer	Finance staff
Chief operating officer	Strategic planning staff
Chief financial officer	Information systems staff
Chief nursing officer	Physician or other provider network development and management staff
Chief information/technology officer	Managed care contracting staff
Chief medical officer	Business development staff
Operational representatives (2–3 members)	Quality or patient experience staff
Physician or clinical representatives (2–3 members)	

Source: Kaufman, Hall & Associates, LLC

investment and key financial risks associated with the investment, including projected financial impact at least two years beyond full operationalization, projected cash flow, net present value and risk-adjusted net present value, and other information
- Qualitative factors, such as mission, growth, safety and quality, customer value, and more
- Sensitivity and risk analyses related to qualitative and quantitative measures
- Identification of performance measures and related potential exit strategies should the investment not meet performance objectives

Large projects may require "way points" for allocation decision making with multiphase planning, review, and approval.

Tried-and-true corporate finance techniques continue to provide the best basis for quantitatively based comprehensive decisions: net present value and risk-adjusted net present value, internal rate of return, and multi-year cash flow projections. While description of these techniques is beyond this article's scope and available elsewhere,[2] boards should be assured that the management process employs quantitative measures to evaluate individual projects and the financial returns of a portfolio of projects. Risk and sensitivity analyses are required as well to assess the likelihood of not meeting individual or portfolio targets.

Qualitative analysis, including criteria such as mission, impact on critical stakeholder groups, safety and quality, competitive position, operating efficiency, infrastructure, and other factors, should complement quantitative analysis to enable complete assessment of portfolio priorities. Criteria should reflect the organization's qualitative priorities and be applied as an alternative screen related to the initiatives once they are ranked based on quantitative analyses.

Oversight Point 5: Approval of Portfolio Recommendations

The capital management council (the centralized management function) should identify priority threshold initiatives for the defined period that collectively fall within the defined capital constraint. If reflecting best practices, this process will involve ranking of projects according to their return on investment using net present value or expected net present value (which incorporates risk), along with several other financial return criteria as the basis for allocation decisions. These quantitative measures should be combined with more qualitative analyses to capture a composite value encompassing mission, strategy, and financial return.

The meeting at which the capital management council allocates funding to threshold capital projects is often viewed as the apex of the executive decision-making process. Council members must be equipped to make effective decisions across the portfolio of potential threshold capital projects.

The board must be confident that the allocation process used by management for this meeting:
- Includes the necessary breadth of quantitative and qualitative information in a format that is consistent and comparable across the variety of potential projects
- Allows sufficient time (at least one week) for review of the materials before the meeting
- Structures the meeting to move at an efficient pace and withholds no critical information

Following capital management council allocation of a portfolio of threshold initiatives, it is typical for the board finance committee to review the recommended portfolio and if satisfied, bring the portfolio to the full board for approval as part of the budget approval process.

The full board has fiduciary responsibility for ensuring that the capital created by the organization and available for spending is reinvested appropriately. The board is *not* expected to review and approve each item in the portfolio. Rather, the board needs to receive a list of the proposed threshold initiatives described in high-level detail, understand the evaluation criteria applied to each item in the list and the list as a whole, and validate the portfolio's connection to the organization's strategy as described in oversight points 4 and 6.

The most important questions for the board at this point are:
- Is the board provided with a specific portfolio of threshold capital projects in which management plans to invest? The key word is *portfolio*. If the answer is "no," the board will not have the big-picture view of investment strategy that will enable the board to fulfill its fiduciary responsibility.
- What is the evidence that the proposed portfolio connects closely and appropriately to organizational strategy?
- What is the portfolio's overall short- and long-term return on financial

2 Jason H. Sussman, *Strategic Allocation and Management of Capital in Healthcare: A Guide to Decision Making (2nd Edition),* Chicago, IL: American College of Healthcare Executives, 2017.

investment and how was this number calculated?

A direct connection to organizational strategy and a positive return for the overall portfolio assure board members that the selected initiatives will collectively create positive momentum for the organization.

Unfortunately, in all too many organizations, the board never receives the list of high-dollar initiatives, but just the total dollar amount of the portfolio. Following approval of this portfolio, the board may first hear about a proposed project when it requires funding, or when the dollars required for the project have increased significantly from initial projections. Having never been aware, for example, that the initial cost estimate for the project was $2.5 million, board members are not equipped to ask why the approval for funding is now $3.5 million. This poses the risk of serious financial shortfalls for the organization.

At a minimum, the board should be receiving from its finance committee or the management team a financial package that provides summary information on the portfolio of threshold investments, and specific pages with standardized details on the status of individual projects, with the supporting calculations and analytics for each.

Oversight Point 6: Integration of Capital Allocation with Broader Organizational Plans

Prior to board approval of the management-recommended portfolio of threshold investments, the rubber must meet the road. The board must confirm that it has received definitive and appropriate answers to the many questions it has asked along the way about how capital spending plans are integrated with the organization's overall strategic, financial, and capital plans, with each step described as follows:

- The *strategic plan* has identified the market- and mission-based strategies that require funding.
- The *financial plan* has quantified potential capital and operating requirements of such strategies and established the annual financial performance targets needed to generate appropriate funding for the proposed strategies.
- The *capital allocation process* has balanced strategic opportunities with financial capabilities, ensuring that capital is deployed to meet the organization's strategic imperatives while enhancing the organization's financial integrity through a portfolio of investment strategies.
- The *annual operating budgeting process* has created a current-year implementation and operating plan, integrating the targets of the strategic and financial plans with the specific investment decisions resulting from the capital allocation process.

The full capital budget, consisting of threshold, nonthreshold, and contingency capital, along with the operating budget, typically are brought by the management team to the board for approval as a package at the same time. The annual operating budget should reflect the first year of the multi-year strategic financial plan and, therefore, becomes a strategic implementation tool. The operating budget should have two parts:

- "Same store" operations, meaning those that are ongoing year-to-year
- Incremental initiatives that are additive to the ongoing budgeted costs of operations

Components of the initiatives that comprise a recommended capital budget will likely impact the operating budget.

An integrated planning cycle requires a highly structured planning calendar, with the sequence of planning activities shown in Exhibit 2. Typically, strategic planning occurs during the first three to five months of the fiscal cycle. Quantification of identified initiatives and their integration into the financial planning process occurs during the next two to three months. This leaves four to seven months to complete the annual operating budget and capital allocation processes. The latter should be scheduled to conclude approximately one month before finalizing the annual operating budget so that management can incorporate amounts allocated and the related operating impacts of selected projects into the appropriate departmental operating budget for implementation.

Capital allocation and management thus is integrally linked with the organization's multi-year strategic, financial, and capital planning processes, as well as its annual budgeting process. To assess the best practice nature of its organization's decision-making

processes, the board should ask the following questions:

- How is the organization's capital allocation and management process connected to its long-range strategic and financial planning?
- Does the capital allocation and management process incorporate the key components described in this section?
- Where and how does the capital budget link to the operating budget?
- Is the planning process calendar-structured and fully integrated?

With satisfactory responses to these questions, the board can feel confident that it has fulfilled its fiduciary responsibilities when approving the capital allocation recommendations of management.

However, the capital allocation and management process does not end when allocation decisions are approved in the capital budget. A *post-allocation process* commences. This process, driven by management and evaluated by the board, includes review and revalidation of projects before their actual funding (i.e., release of funds), decision making regarding the timing of capital spending, handling of any budget deficits or surpluses that occur, ongoing monitoring of capital spending, and determining the appropriate course of action based on performance results.

The board plays an oversight role in the post-allocation process as well, particularly with funding review and revalidation and performance review, as described next.

Oversight Point 7: Project Funding

Most organizations require some form of revalidation of project parameters by the management team before funding is approved by the board for allocated threshold capital. This ensures that new data or information obtained following approval of the capital budget can be taken into account, integrated appropriately, and evaluated according to previous quantitative and qualitative criteria.

In many organizations, project sponsors are required to update business plans when actual funding is required for approved threshold capital projects. This revalidation of the original business plan should rely on the same data and analyses that substantiated the original allocation decision (e.g., projected cash flows and financial ROI). In the time that has elapsed between the allocation decision and the need for funding, some of the project parameters will have changed (some perhaps materially).

The revalidation process captures these changes and their impacts on project quality, thereby improving the board's ability to perform its fiduciary duties. When a specific capital project is brought to the board for funding, the board has the assurance that the project has been thoroughly and consistently analyzed by the sponsoring and management teams, has been established as a priority strategic investment for the organization, and has been vetted for any material changes that would affect the direction of the original allocation/budgeting decision.

The board, of course, should have previously seen the project as part of the recommended capital budget and should be aware already of its imminent funding requirement. The board also should have a complete understanding of the sources of funding for the project, including whether or not the project will require external debt or will need to access the contingency pool.

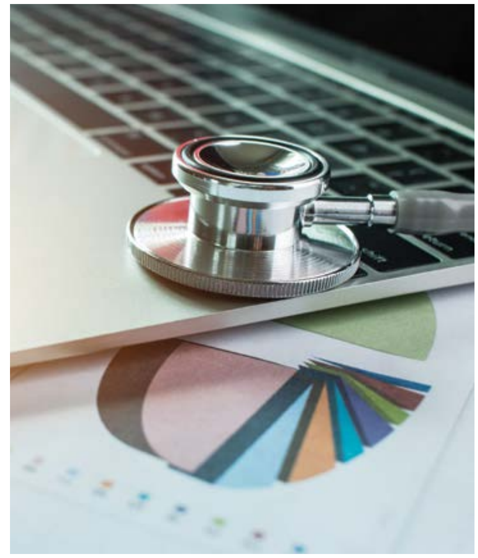
Most organizations have established levels of authority relative to funding approval for high-dollar projects included in the capital budget (the "Authority Matrix"). For example, depending upon the size of capital budgets, organizational bylaws may stipulate that:

- Prior to funding, the board must review and approve projects approved for $X million or more of threshold capital
- Funding approval for projects under this sum remain under the aegis of the management team

As the size of the organization and its capital spending increase, the approval sums typically should rise as well. Large projects, particularly those with associated debt, divestitures of material assets, and creation of a new corporation or joint venture, typically should require board approval prior to funding.

It is important that definition of the Authority Matrix for each organization be structured to reflect its size, complexity, and risk culture, but not create barriers to efficient and effective decision making and strategic implementation. To ensure this is the case, the board should have answers to the following questions:

- Are levels of authority for funding approval established in the organization?
- How frequently are such levels evaluated based on the size and complexity of the organization?
- What analyses does management provide the board for review and approval of project funding?
- Are these analyses consistent with those originally provided at the allocation decision-making point?



Consider an unfortunately not-infrequent example of a $2 million project originally approved by the board as part of the capital budget based on solid analytics. Sometime later in the fiscal year, but prior to full implementation of the capital budget, the project is presented to the board for funding approval at a cost of $3 million.

The board should ask the following questions and expect appropriate answers at the time of the funding request:

- Why has the cost of the project increased so materially?
- Does the project still meet the strategic goals and financial ROI targets of the organization?
- Where is funding for the increased capital going to come from?
- Will another or other projects need to be deferred or can the contingency pool cover this cost overrun?

- If we approve funding, what are the implications to the long-term financial plan?

Analyses required for the board to approve this project include strategic and financial projections, ROI/net present value studies, and additional sensitivities around risk factors. The higher investment-funding request may, or may not, undermine the economics of the project.

The revalidation process should not be viewed as another chance to question the project's legitimacy. Rather, revalidation should verify that the project's original premise remains solid, that the key assumptions continue to be supported, and, most important, that the project's investment requirements remain consistent with the original request or can be supported by the financial plan.

Oversight Point 8: Performance Review

Post-approval performance review and monitoring is vital to the integrity of the capital allocation and management process. Management teams in successful organizations define quantifiable indicators of project success as part of the initial project analytics, measure performance against these indicators, and devise and implement plans to respond to less-than-anticipated performance.

Management should define the post-allocation monitoring timeframe for review of every approved threshold capital project. For example, one organization established guidelines that indicate the following: Threshold capital projects, including projects in which operations begin in the first investment year and multi-year projects in which operations do not begin in the first investment year, will be reviewed annually as part of the management component of the capital process until after the project has completed one full year of operations post completion. In this organization, projects with a long build-out or start-up periods could be required to undergo annual reviews for several years.

Post-allocation, retrospective analysis should mirror the prospective, business planning analysis prepared in support of the original allocation decision. Benchmarks and metrics related to both qualitative and quantitative aspects of the project should be based on the benchmarks and metrics used in the project's business plan.

Both management and the board must have and foster an understanding that not all projects for which capital is allocated will be successful. Because this is an axiom of business planning, it is vital that each project request include specific metrics that define the point at which the "plug should be pulled" on an underperforming investment. In addition, the business plan should include a defined, specific exit strategy that will be implemented in such an instance. Many healthcare organizations wait far too long to either modify or terminate bad capital investment decisions.

Boards must ensure consistent development and successful implementation of corrective strategies, not simply

effective performance monitoring. The practice of demanding corrective action plans in response to underperformance on capital and financial plans is critical.

Board questions at this final point of oversight include:

- What process is used for evaluating project progress following post-allocation and funding?
- What is required of management when a project is not meeting expected performance targets?
- How are steps to address underperformance implemented?

Resources Going Forward

In an environment of scarce resources, increasing competition, and significant requirements for capital investment, healthcare management teams must allocate available capital to initiatives that will best meet the strategic objectives of their organizations while enhancing financial performance. In almost all healthcare organizations, capital appetites routinely exceed capital constraints. Choices will need to be made. Use of a disciplined capital allocation and management process is critical. The oversight provided by boards at the eight touch points described here will better ensure the effectiveness of such a process for the organization as a foundation for its success going forward.

The Governance Institute thanks Jason H. Sussman, Managing Director of Kaufman Hall and a leader with the firm's Strategic and Financial Planning practice, for contributing this article. He can be reached at jsussman@kaufmanhall.com.