



## Hospital Sector Financial Stress Requires Governing Board Adaptation

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**The United States hospital sector has experienced severe and unprecedented post-pandemic financial stress.** Analysis from late 2022 is sobering. Across diverse geographic sectors and hospital types, margins remained depressed, about half of hospitals were projected to have negative margins for the year, expenses continued to escalate, and patient volumes and case management continued to show vulnerabilities.<sup>1</sup> More current data from April 2023, while showing some evidence of modest improvement, underscores that these margins are generally thin at best, that inflationary pressures and workforce expense issues persist, and that patient volumes and lengths of stay need careful management.<sup>2</sup> For hospital and health system governing boards, these challenges should be reflected in focused fiduciary oversight practices.

### Possible Board Oversight Approaches

As detailed in a Governance Institute E-Briefings article,<sup>3</sup> each hospital or health system governing board should consider developing an enhanced financial oversight approach that reflects its reality.

*For organizations experiencing some measure of financial distress,* it may be appropriate to undertake an integrated and intensive initiative that goes beyond the current work of the finance and strategic planning committees of the board. Possible measures include:

- Convening an *ad hoc* committee, comprised of representatives from multiple standing committees, to undertake a deep dive into short-term and long-term

1 Kaufman Hall, [“The Current State of Hospital Finances: Fall 2022 Update.”](#)

2 Kaufman Hall, [“National Hospital Flash Report,”](#) April 2023.

3 Anne Murphy, [“The Governing Board’s Role in Assessing Possible Hospital Closure or Downsizing,”](#) E-Briefings, The Governance Institute, May 2020.

financial, strategic, and operational challenges and opportunities. In the alternative, key standing committees could be charged with evaluating certain aspects of these challenges and opportunities, informed by post-pandemic realities, and reporting findings to the board.

- Whichever approach is taken, construct clear expectations with the senior management team as to respective roles and responsibilities.
- Consider retention of outside consultants to advise the board and/or the senior management team on financial performance, market realities, and possible strategies for performance improvement.
- Understand the expected deliverables and decision points to emanate from this intensified financial oversight approach. Possible approaches include a final report or roadmap, instructions to management to explore certain strategic and operational initiatives, and development of additional performance metrics that will be assessed and as appropriate, will trigger additional board action.

*For organizations facing immediate financial distress*, particularly if viability is in question or insolvency is possible, it will be necessary to undertake an immediate and action-oriented governance approach. Measures should include:

- Immediately retaining outside advisors, including turnaround consultants and outside legal counsel, to advise in an expedited manner. If insolvency is possible, it is imperative that qualified legal counsel advise management and the board.
- Clearly identifying which committees of the board have responsibility for overseeing certain possible responses and actions, such as 1) downsizing or closure of facilities or service lines, 2) loan restructuring, 3) vendor negotiations, and 4) merger or consolidation exploration.
- In formulating a response, recognize that there likely will be the need to coordinate and seek approvals from federal, state, or local governmental bodies. This may take time, and this turnaround needs to be understood and embedded within the plan. For example, in numerous states, a regulatory body must review and approve a hospital closure or downsizing plan. And for non-profit organizations, the state Attorney General may require review of a significant change to operations or membership.

## **Current Financial Performance Governance Considerations**

As a hospital or health system governing board develops an approach to intensify oversight of financial performance, it should discuss with senior management

and evaluate certain external and internal current events and anticipated realities, including the following:

- The effect the **expiration of the public health emergency** will have on financial performance.
- **\$8 billion in annual DSH payment cuts** are planned to take effect October 1, 2023. Congresswoman Yvette D. Clarke (D-NY)—joined by Reps. Crenshaw, (R-TX), DeGette, (D-CO), and Burgess (R-TX)—recently introduced a bill asking to delay these cuts until 2026.<sup>4</sup> While Congress has previously delayed these cuts, there is no assurance this will happen again. For many hospitals, these DSH cuts would be destabilizing.
- Sustained inflationary pressure, resulting in **persistent increases in supply chain costs**.
- **Workforce shortages**, with resulting increased labor costs, workforce burnout, reliance on nurse registries, and limitations in optimizing patient care and volume.
- **Details of patient metrics**, including trends in inpatient and outpatient volumes. Are outpatient volumes increasing? Is patient length of stay trending up or down, and what does this mean for the organization’s stability? Is patient case management aligned with best practices?
- Strategies for **access to post-acute services**, in order to facilitate timely patient discharge. For many hospitals, lack of sufficient access to these post-acute services has created urgent patient discharge bottlenecks.
- A detailed **assessment of financing covenants**, in order to understand which, if any, the organization might be at risk of breaching. If such a breach is a possibility, the finance committee should discuss with senior management and legal counsel the potential ramifications of such a breach and whether any mitigating steps should be undertaken now.
- If a merger, sale, or consolidation strategy is being considered, recognition of **the Biden Administration,<sup>5</sup> U.S. Department of Justice,<sup>6</sup> and Federal Trade Commission,<sup>7</sup> skepticism of hospital mergers and consolidations**. The combined effect of this stance is that, despite sector-wide financial stress, a proposed

4 See [H.R.2665, Supporting Safety Net Hospitals Act, 118th Congress, 2023–2024](#).

5 The White House, [“Fact Sheet: Executive Order on Promoting Competition in the American Economy,”](#) July 9, 2021.

6 The United States Department of Justice, [“Justice Department Withdraws Outdated Enforcement Policy Statements,”](#) February 3, 2023.

7 Harris Meyer, [“Biden’s FTC Has Blocked 4 Hospital Mergers And Is Poised To Thwart More Consolidation Attempts,”](#) The Lund Report, July 20, 2022.

hospital combination strategy may see much greater federal scrutiny than in prior years.

- The **state of value-based care** in the market, and the organization's current progress toward profitable value-based care service lines.
- Critical assessment of **commercial and government reimbursement levels**, and analysis of service line and facility performance.
- If **service line/facility downsizing or reduction** is possible, carefully consider regulatory notice and approval requirements, patient safety considerations, and reputational implications.

### → Key Board Takeaways

- As unprecedented financial stress persists across the hospital sector, directors should consider whether adjusting the board's approach to governance oversight is warranted. This oversight modification may vary depending on whether the organization is either 1) experiencing some measure of financial distress, or 2) facing immediate financial distress in which viability is in question or insolvency is possible.
- For organizations experiencing some measure of financial distress, the board can organize a more focused approach to oversight by convening an interdisciplinary *ad hoc* committee, or instead charging standing committees with certain elements of financial and performance oversight. Clear expectations of metrics and deliverables should be developed in collaboration with senior management, and possibly with the assistance of outside consultants.
- For organizations facing immediate financial distress in which viability is in question or insolvency is possible, it is imperative to take an immediate and action-oriented governance oversight approach. This will include retention of outside advisors, clear lines of responsibility at the governance and management levels, and evaluation of legal requirements and risk.
- Once an oversight approach is developed, the board should ensure that senior management is apprising it of current market and regulatory realities that may have a dramatic effect both on future financial performance and potential responses to it. In addition, a detailed assessment of financing covenants may be beneficial.

## Conclusion

Hospital and health system governing boards should consider enhanced oversight of certain financial, operational, and strategic planning areas, in response to organizational financial stress. This may require a modified procedural approach by the board to certain oversight duties, and also should cause the board to evaluate with management and, as applicable, outside advisors, emerging external and internal cost, revenue, market, legal, and financial realities.

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