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Academic Health Focus



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Getting a Handle on Academic Funds Flow

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Understanding the flow of funds within an academic health system is one of the greatest challenges that board members face.

Funds flow models are complex and vary significantly from organization to organization: “if you have seen one funds flow model, you have seen one.” Operational disruptions and financial challenges over the past few years have, however, constrained margins at many academic health systems. For board members to exercise proper fiduciary oversight, it is more important than ever that they, first, understand funds flow and, second, ensure that their organization’s funds flow model aligns with key characteristics of best practice models that drive progress toward organizational objectives.

A Simplified Look at Funds Flow

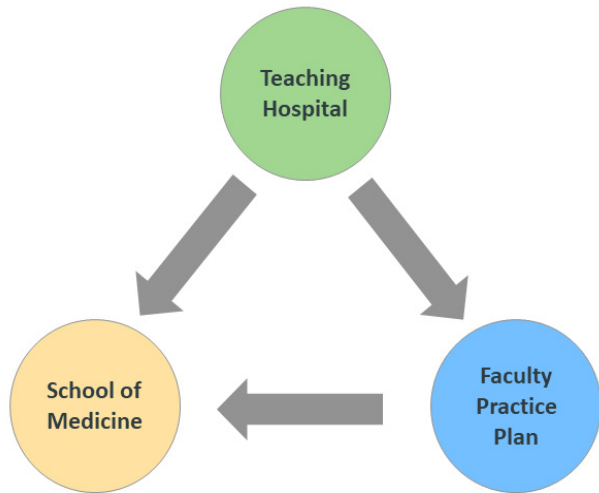
Despite the many variations in funds flow models across different academic health systems, funds flow at all organizations is intended to support the tripartite mission of the academic health system: clinical care, research, and teaching.

The three main entities within the funds flow model are the teaching hospital, the faculty practice plan, and the school of medicine. Each of these entities will have their own strategic objectives, as will the enterprise as a whole, and any funds flow model should embrace three key concepts to meet these objectives:

- Mechanisms to **increase the connection between funding and strategic objectives**, creating variable elements where possible.
- **A structure across the enterprise** that aligns incentives to grow a sustainable pie for all.
- **Shared decision making** in allocating funding to support aspects of the **tripartite mission**.

The teaching hospital is the locus for clinical care—the primary revenue generator in the model—while the school of medicine supports teaching and research, and the faculty practice plan works in all three areas. In simplified form, the basic flow of funds follows the pattern shown in the exhibit below.

This simplified model shows a unidirectional funds flow from the teaching hospital to



the faculty practice plan and school of medicine, and from the faculty practice plan to the school of medicine. The reality is a bit more nuanced; the school of medicine, for example, may transfer graduate medical education (GME) funds to the teaching hospital to support resident and fellow expenses. But this simplified model shows the predominant direction of funds flow with an academic health

system, and the teaching hospital is the primary source of the funds.

Academic health systems and teaching hospitals have generally fared better than community hospitals in the operational and financial disruptions of the past few years, but their margins have also been compressed. If a 6 percent positive operating margin at the teaching hospital in pre-pandemic years has become a 3 percent positive operating margin today, there has been a significant diminution of the funds that are flowing through the system. This is why board members must be more attentive than ever to the structure and transparency of their organization’s funds flow model.

The Questions Board Members Should Ask

It is very easy to quickly be drawn deep into the nuances of academic funds flow. But board members can start with a simple question: in aggregate, what is the net funds flow among the three entities (i.e., teaching hospital, faculty practice plan, and school of medicine)? As a follow-up question: does this figure include *everything*—are there any side deals that have been struck that may not be included in this aggregate figure?

Board members may also want to ask: are we paying too much? That is understandable, but there are two more important questions:

- Is our current funds flow model sustainable, given the available resources and the strategic objectives and priorities of the enterprise as a whole?

- Is our funds flow model structured appropriately to support key strategic initiatives of the enterprise?

These questions may not be easy to answer because of the number and complexity of agreements that are typically involved in a funds flow model. If answers can be directly addressed, all the better. But if there are difficulties in arriving at a conclusive answer, board members should work with leadership to ensure that the organization's funds flow model reflects the characteristics of best practice models, which will increase transparency, support the board's exercise of its fiduciary duty, and better allocate resources for optimal use based on the objectives of the enterprise.

Key Characteristics of Best Practice Funds Flow Models

Funds flow models take many shapes, influenced by differences in the academic health system's structure, mission, culture, strategic initiatives, and financial realities. Across the many varieties of models, however, there are several key characteristics that are considered "best practice," regardless of the model's structure (see sidebar below).

Best practice funds flow models are:

- **Aligned:** The model is structured around each party's identified ability and mechanisms to contribute to the enterprise's strategic objectives. It includes pools of dollars that are contingent but available for strategic priorities that jointly benefit all parties' performance.
- **Flexible:** The model contains a range, with ceilings and floors based on performance, and flexible metrics to meet value-based payment requirements and other evolving clinical payment models, as well as other environmental changes.
- **Sustainable:** The funds flow model is built on a realistic and sustainable foundation. It results in sufficient resources over multiple years across all missions to drive success.
- **Transparent:** Overall funds flow is reported on a regular (e.g., quarterly) basis, including projections for the remainder of the fiscal year. All parties can understand the model, including their ability to positively impact the results of the entire enterprise.
- **Manageable:** The plan is driven by defined and reportable metrics, which drive financial and strategic success. The plan can be administered with a reasonable amount of effort, including the ability to manage and report performance.

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A successful funds flow model, whatever its shape, requires a process that achieves several objectives. It must be sensitive to organizational structure, culture, and strategic priorities. It must effectively engage key stakeholders throughout the enterprise to drive activity that creates value for the tripartite mission. It must be grounded in financial realities and implications. And it must clearly define trade-offs among the parties and facilitate their collaborative journey together, consistent with the enterprise's mission. By ensuring that the organization's funds flow model exhibits the key characteristics outlined above, leadership and the board will help ensure that these objectives are realized.

Key Board Takeaways

- Recent financial pressures have put additional strain on academic health systems' funds flow models. These pressures make the board's fiduciary oversight of funds flow more important than ever.
- Board members should ask for the net funds flow, in aggregate, among the three main entities in the enterprise (teaching hospital, faculty practice plan, and school of medicine), understanding that finding an answer to this question may be difficult to obtain, given the nuances and complexities of many funds flow models.
- If an answer to the question of net funds flow is difficult to obtain, board members should work with leadership to ensure, first, that net funds flow is transparent and readily understood and, second, that key characteristics are in place to promote the transparency, sustainability, efficiency, and manageability of the model.
- While the amount of funds moving within the model is of interest to the board, the more significant question is whether those funds are sustainable over time and designed to support the key strategic initiatives of the enterprise as a whole.
- By ensuring that the funds flow model reflects several key characteristics, leadership and the board can help ensure that the model is facilitating collaboration among the missions and joint investment that helps the entire enterprise achieve its objectives.

The Governance Institute thanks Dawn Samaris and Matthew Bates, Managing Directors, Kaufman, Hall & Associates, LLC, for writing this article. Dawn can be reached at dsamaris@kaufmanhall.com and Matthew at mbates@kaufmanhall.com.

