The Board’s Role in Organizational Finance

**EXECUTIVE SUMMARY**

- Health care reform will result in significant changes in reimbursement with much greater emphasis put on primary care, home care, and other types of non-acute care.
- The changes in reimbursement will necessitate significant changes in organizational structure and operations.
- It is essential board members keep current in their knowledge of health care finance so they can execute their responsibilities for the financial health of the organization.
- The board must ensure that the budget is aligned with the organization’s financial objectives and monitor the financial performance.
- It is essential the chief nursing officer (CNO) contributes to the board’s understanding of the financial health of the organization.
- The board of trustees will more effectively execute their financial responsibilities with the input of nurse trustees and the CNO.

**THE FINANCIAL VIABILITY OF the hospital and the quality of care are the two key responsibilities of the board of trustees. The recent focus on health care reform resulted in national awareness of the high costs of the American health care delivery system. There is broad agreement health care costs must be reduced and access to health care must be increased. The many changes that will result from health care reform will provide challenges to all of the hospital’s stakeholders. The final responsibility for their successful implementation and financial health of the organization remains with the board of trustees. Most of the hospital’s revenue comes from the federal, state, and private insurance plans. Recent developments like “never events” identified a set of patient complications and negative events for which insurers will not pay hospitals. In the near future, patient re-admissions will be excluded from insurance payments. It is essential board members keep current in their knowledge of health care finance so they can execute their responsibilities for the financial health of the organization. Most of the health care revenue goes to hospitals (33%), physicians (23%), and pharmaceuticals. Health care reform will result in significant changes in reimbursement with much greater emphasis put on primary care, home care, and other types of non-acute care. The changes in reimbursement will necessitate significant changes in organizational structure and operations.**

**Types of Organizations**

There are three basic forms of health care organizations: not-for-profit, investor owned, and governmental health care organizations. Not-for-profit health care organizations are the most common type. They are owned by the community, not investors. They are expected to provide a public benefit, often described as charity care. In return for their charitable work, they are exempt from federal income taxes and property taxes. In recent years nonprofit organizations have been expected to prepare reports supporting their charitable work and its value. If the amount of public benefit is inadequate, a not-for-profit organization can lose its tax-exempt status.

Investor-owned health care organizations are often referred to as for-profit. Their main objective is to generate profits for their shareholders and they pay taxes on their earnings. Governmental health care organizations are owned by the federal, state, or local government. We are familiar with the Veterans Administration hospitals, state, county, and city hospitals. Some governmental health care organizations actually have taxing authority.

The board’s financial responsibilities include approving the financial objectives and the budget that is developed by management and the board’s finance committee. The board must ensure that the budget is...
aligned with the organization’s financial objectives and monitor the financial performance. Not-for-profit organizations are able to borrow money through the use of low-cost municipal bonds. The owners of these bonds often require certain types of financial reports and identify key metrics that must be upheld to comply with the bond covenants.

Key Reports

One of the key reports that the board relies upon is the “income statement.” The income statement looks at revenue compared to expenses to provide a figure called “net income.” A second key financial report is the organization’s “balance sheet.” The balance sheet is a snapshot in time that communicates the difference between what the organization owes and what it owns. The difference is referred to as “owner’s equity.” In our personal lives we often calculate our net worth by comparing what we owe to what we own. Board members usually receive the income statement and balance sheet on a monthly basis.

Management is responsible for creating financial reports that communicate the financial condition of the organization. Management is expected to be good stewards of all human and material resources. It is essential to monitor signs of financial risk. One major area of risk is declining patient volume which indicates the organization is losing market share and perhaps is not competing effectively for patients. In the recent recession hospitals experienced a significant decline in elective procedures and admissions which had negative effects on their financial performance. Other warning signs of financial risk are decreases in cash available to meet operating and capital needs and increasing amounts of debt. Many boards are requesting monthly dashboards or financial report cards to measure and manage these financial risks.

An annual audit is essential to determine if management is presenting the organization’s financial position fairly. The board’s audit committee is made up of independent (having no financial relationship with the hospital) board members. The audit committee selects the audit firm, defines the scope of the annual audit, and determines if the organization has effective internal financial controls. The audit firm reports to the board of trustees.

Financial Metrics

There are a few key financial metrics board members monitor very closely. “Days cash on hand” refers to the number of days an organization can meet its average daily operating cash outlays. It indicates how long the organization can meet its financial obligations with cash. The higher the number of days cash on hand, the better. The minimum number of days cash on hand is often stipulated by the organization’s bond holders. “Days in accounts receivable” is another key metric. It communicates how long it takes the organization to collect its debts. The lower this number, the better. If the organization is efficient in collecting debts it can use that cash for expenses and investments. “Return on equity” is a third key metric. It is a measure of what is happening to the total value of the organization over time. Obviously it is better if there is a strong, positive return on equity.

The board of trustees is responsible for the financial health of the organization. The board works closely with management to develop the budget and to monitor the organization’s financial performance. The board usually receives monthly scorecards and financial data. Health care reform will stimulate many changes in the health care organization’s revenue and expenditures. Nurse board members can be very effective in helping the board to understand organizational operations. Nursing is often the largest single budget category and it is essential the board understands nursing translates into most aspects of patient care. If the chief nursing officer (CNO) attends the board meetings, it is an important opportunity for the CNO to describe how nursing is contributing to cost controls and efficient hospital operations.

Ensuring Financial Health

One of the primary responsibilities of a health care organization’s board of trustees is to ensure the financial viability of the organization. Not-for-profit, investor owned, and governmental health care organizations must focus on managing their revenues and expenditures. Health care reform is creating many changes in the ways hospitals will be reimbursed and in approaches to revenue generation. Many systems are creating strategic plans to provide new approaches to the organization and operations of their facilities. Nurse board members are very helpful in communicating the issues related to finance and organizational operations. Nursing can play a key role in describing “mission critical” programs as well as identifying new approaches to care giving. It is essential the CNO contributes to the board’s understanding of the organization’s financial health. The board of trustees will execute their financial responsibilities more effectively with the input of nurse trustees and the CNO.