

The Board's Role In Financial Oversight



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Why should the Board worry about finances?

“The governing entity approves the hospital’s capital and operating budget(s) and allocates other resources required to meet the hospital’s mission.”

Joint Commission International Accreditation Standards for
Hospitals GLD.1.1

Two Functions of the Board

1. Approval: Operational budgets, capital budgets, non budgeted items, and turn around plans.
2. Monitoring: Are the approved items being implemented? Financial statements, audits, and board reports.

How knowledgeable about finances do directors have to be in order to discharge their duties?

Learning Objectives

The board member's understanding of:

1. The information needed in order for the Board to fulfill the duty of approval of financial items.
2. The process that is used to obtain the information needed to approve financial items.
3. The information needed for the Board to fulfill the duty of monitoring the financial progress of an institution.
4. The process that is used to obtain the information needed to monitor the financial progress of an institution.
5. It is not an objective to make board members accountants or finance experts.

Part 1

Approval

April 25, 2021

- Section 1: Review Board Basics.
- Section 2: Operating Budgets.
- Section 3: Capital Budget and Approval of Non-Budgeted Items.
- Section 4. The Role of the Finance Committee.
- Section 5: Case Studies/Questions and Answers.

Part 2

Monitoring

May 23, 2021

- Section 1: Understanding Financial Statements.
- Section 2: Financial Audits.
- Section 3: Case Studies/Questions and Answers.
- Financial turn around plans will be presented in the session titled “The Board's Role In Planning”.

Financial Budgeting

1. A budget is a one year financial plan. It is more than numbers.
2. The quality and accuracy of a budget is based upon the knowledge of the past, present and assumptions of the future. This is called situation awareness.

The Financial Problem That Should Not Have Happened

Several years ago Adventist Health International was requested to look at the financial operations of a mission hospital. This hospital was losing about \$50,000 US per year and was struggling to make payroll and pay vendors. A review of the hospital's last 5 years of operations revealed the trend shown on the following slide.

What happened between the years 2012
and 2013 that created this financial
crisis?

One question from a board member
might have prevented this crisis.

Board Basics

- Attend meetings.
- Obtain information.
- Engage.
- Determine situation awareness.
- Take appropriate action.

Situation Awareness

The knowledge of current elements and events, the understanding of their meaning, the projection of their future status and impact on the organization.

Outstanding leaders and successful boards have situation awareness.

Board Basics

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Basic Definitions

Types of Accounting

Cash accounting is where income and expenses are realized when they are received or paid.

Accrual accounting is where you realize the income when you provide the service and realize the expense when you have taken the service. This type of accounting creates accounts receivable and accounts payable.

Basic Definitions

In-Patient: Those patients that receive treatment at the hospital and are admitted, usually at least over night.

Out-Patient: Those patients that receive a treatment in the hospital but, after a short recover time (less than 24 hour) leave the hospital.

Basic Definitions

Salaries and Wages: The cost for the employees of the organization. 45%-60% of the budget.

Benefits: Health care, retirement, payroll taxes etc.
20%-30% of wages and salaries.

Professional Fees: Cost of the audit, consultants, legal, etc.

Basic Definition

Depreciation

You purchase a piece of medical equipment for 250,000. Because of technology changes and use, the piece of equipment will decline in value over time.

When you purchase the equipment it becomes an asset of the hospital and is part of the property and equipment entry on the financial statement.

It is determined that the useful life of this piece of equipment is 5 years. Therefore you depreciate the asset each year until at the end of 5 years its value is 0.

Question: Where will the funds come from to replace the equipment in 5 years?

The Answer

From the financial gains, profit, net surplus, income minus expenses, etc.

Besides funding for replacement of depreciated equipment, principal payment on debt, remodels, expansion of services and financing reserves must be from the yearly financial gains.

What happens if there are no financial gains?

Budgeting Process

1. Senior administration, CEO and CFO, sends a draft budget to department heads. Draft includes assumptions.
2. Department heads review and provide feedback to senior administration.
3. Budget is reviewed and approved by Administrative Committee.
4. Budget is reviewed by the Finance Committee.
5. Recommended changes are made by administration.
6. Budget is presented to the Board for approval

**Budget
2021**

Revenue

In-Patient	15,000,000
Out-Patient	2,000,000
Gifts/Donations	0
Investment Income	0
Other Income	12,000
Total Revenue	17,012,000

Expenses

Salaries/Wages	6,500,000
Benefits	1,950,000
Drugs & Supplies	6,000,000
Depreciation	75,000
Professional Fees	50,000
Other Expenses	280,000
Total Expenses	14,855,000
Net Income/(Loss)	2,157,000

What Questions Should Board Members Ask?

Remember “Situation Awareness”- Past, Present, Future.

For an understanding of the future I need to be informed of the past and the present.

Where is the comparative data from the past and the present?

	FY 2018	FY 2019	Projected FY 2020	Budget 2021
Revenue				
In-Patient	11,000,000	12,000,000	12,500,000	15,000,000
Out-Patient	750,000	800,000	850,000	2,000,000
Gifts/Donations	0	0	10,000	0
Investment Income	0	0	0	0
Other Income	10,000	11,000	12,000	12,000
Total Revenue	11,760,000	12,811,000	13,372,000	17,012,000
Expenses				
Salaries/Wages	5,000,000	5,200,000	5,100,000	6,500,000
Benefits	1,500,000	1,560,000	1,530,000	1,950,000
Drugs & Supplies	5,000,000	5,500,000	6,000,000	6,000,000
Depreciation	85,000	80,000	75,000	75,000
Professional Fees	70,000	60,000	60,000	50,000
Other Expenses	300,000	250,000	220,000	280,000
Total Expenses	11,955,000	12,650,000	12,985,000	14,855,000
Net Income/(Loss)	(195,000)	161,000	387,000	2,157,000

**Would you now approve this
budget?**

NO

**There is no information about the
future. This would be contained
in the budget assumptions.**

What Questions Should Board Members Ask? Some of the answers will be the assumptions for the budget.

0. Does the budget support the mission?
1. What explains the differences between the past, present and the proposed budget?
2. Have you included inflation in the revenue and expense items?
3. Will the case mix or the payer mix change?
4. Will there be an increase in the hospital reimbursement?

What Questions Should Board Members Ask? Some of the answers will be the assumptions for the budget.

5. Are there any new services that will be offered in 2021?
6. Are there any existing services that will be reduced or terminated in 2021?

What Questions Should Board Members Ask? Some of the answers will be assumptions for the budget.

7. Will there be any changes in the number of employees?
8. Will there be any pay increases for the employees?
9. Are there any promotions of employees?
10. Will the employee benefits stay the same?

What Questions Should Board Members Ask? Some of the answers will be the assumptions for the budget.

11. The hospital has debt to pay where are the interest and principal costs?
12. What all is included in the professional fees?
13. You have increased the in and out-patient revenue but the medical supplies expenses are staying the same as in 2020. Why?

Who is going to ask all of these questions?

Are we going to use board time to ask and obtain the answers?

Will administration have time to prepare answers during the board meeting?

**What was the question that was
not asked?**



Example of Situation Awareness

Inflation in the country was 5% per year.

Expenses were increasing by 5% but the contracted reimbursement stayed the same.

The question that should have been asked was:

“What income and expense adjustments have been made in the budget for inflation?”

Approval Of Capital Items or Non-Budgeted Items

Piece of equipment (CT scanner, X Ray machine,
new Medical Information System. Etc.)

Remodel of the facility.

Items that exceed the spending authority of the
administration.

Approval of Non-Budgeted Items

Example of Spending Limits

Under 20,000 -----Approved by CEO

20,000 to under 50,000-----Approved by the Hospital
Board Executive Committee

Over 50,000-----Approved by the hospital
Board.

Information Needed for Approval of a capital or non-budgeted item.

The Problem?

The Solution?

The Cost?

The Financial Analysis?

Source of the Funds?

Request For Capital Item

At the end of the presentation would you vote to approve the purchase?

Does the presentation demonstrate administration's "situation awareness"?

Does the presentation give me "situation awareness" allowing me to have an informed vote?

What financial knowledge did I need to be informed and vote on the request"?

Sample Approval Request

The Problem: The hospital has a financial, quality of care and patient safety problem. The hospital has 2 operating theaters with 2 anesthesia machines. One of the machine failed and cannot be repaired. The mutual support agreement with the government hospital has been activated and one anesthesia machine has been borrowed from the government hospital. However, this borrowed machine must be returned to the government hospital in 7 days. Without 2 functional operating theaters the hospital will have to cancel an average of 8 surgeries per day and it is estimated that lost revenue is 20,000 (12,000 to cover direct expenses and 8,000 contribution) per day.

Sample Approval Request

The solution:

A local vendor has a new machine for sale for 200,000. The purchase of this machine is supported by the anesthesiologists. They are trained on this machine and it is compatible with the hospital's systems. The machine comes with a 5 year warranty and a 10 year maintenance contract. It can be delivered in one day.

Sample Approval Request

The cost

The total cost of the machine, including taxes, delivery, installation, warranty and 10 years of maintenance is 200,000.

Sample Approval Request

Financial Analysis

The hospital is losing 20,000 per day in revenue. Of this amount 12,000 covers direct expenses and 8,000 is contribution. This revenue would not be lost if the new machine is purchased. Costing 200,000 the pay back is 25 days. (200,000 divided by 8,000).

Sample Approval Request

Source of Funding

The funds would be taken from reserves which are currently invested in a local bank. The expenditure of 200,000 would not reduce required cash or financial ratios below required minimums.

Suggested Board Action

1. The Board to vote to waive the policy requiring three bids be obtained for the purchase of medical equipment. (The bidding process would require at a minimum 21 business days and would result in losing 21 days of business. This would be a loss of 168,000 in contribution. The bidding process could save approximately 20,000 in the purchase price.)
2. The Board vote to approve the purchase of an anesthesia machine for 200,000.

Request For Capital Item

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Who is going to ask all of these questions?

Are we going to use board time to ask and obtain the answers?

Will administration have time to prepare answers during the board meeting?

Appoint a Finance Committee of the Board

1. The board selects the members and the chair.
2. The board clearly, in writing, states the terms of reference for the committee, includes their duties and authority if any.
3. This committee meets before the board, leaving sufficient time for the administration to gather the information which answers the questions.

Summary-1

As a board member you are asked to approve financial budgets and capital expenditures and monitor the financial position of the institution.

If you will remember the concept of situation awareness, information of the past, the present and the future, and require administration to provide you with this information you, with minimum knowledge about finances, will be able to make educated decisions.

Summary-2

As a board member you are asked to approve financial budgets and capital expenditures and monitor the financial position of the institution.

If you will remember the concept of situation awareness, information of the past, the present and the future, and ask questions of administration you, with minimum knowledge about finances, will be able to make educated decisions.

Use a finance committee to process the budgets and financial information in sufficient time before the Board meeting to allow administration to gather the requested information and answers.

Case Studies
And
Questions and Answers