

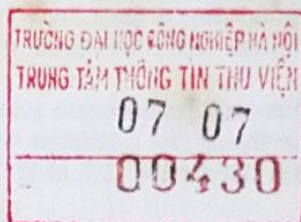
# Essentials of Health Care Organization Finance



Dennis D. Pointer  
Dennis M. Stillman

A Primer for Board Members

# Essentials of Health Care Organization Finance



A Primer for Board Members

DENNIS D. POINTER  
DENNIS M. STILLMAN

GIFT OF THE ASIA FOUNDATION  
NOT FOR RE-SALE

QUÀ TẶNG CỦA QUỸ CHÂU Á  
KHÔNG ĐƯỢC BÁN LẠI



JOSSEY-BASS  
A Wiley Imprint  
[www.josseybass.com](http://www.josseybass.com)



Copyright © 2004 by Dennis D. Pointer and Dennis M. Stillman. All rights reserved.

Published by Jossey-Bass

A Wiley Imprint

989 Market Street, San Francisco, CA 94103-1741 [www.josseybass.com](http://www.josseybass.com)

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8700, or on the web at [www.copyright.com](http://www.copyright.com). Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, e-mail: [permcoordinator@wiley.com](mailto:permcoordinator@wiley.com).

Jossey-Bass books and products are available through most bookstores. To contact Jossey-Bass directly call our Customer Care Department within the U.S. at (800) 956-7739, outside the U.S. at (317) 572-3986 or fax (317) 572-4002.

Jossey-Bass also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

### Library of Congress Cataloging-in-Publication Data

Pointer, Dennis Dale.

Essentials of health care organization finance: a primer for board members/  
Dennis D. Pointer, Dennis M. Stillman.—1st ed.

p.; cm.

Includes index.

ISBN 0-7879-7403-X (alk. paper)

1. Health facilities—Finance. 2. Health facilities—Business management. 3. Hospital trustees.

[DNLM: 1. Financial Management—methods. 2. Health Facilities—economics. 3. Governing Board—standards. WX 157 P752h 2004]  
I. Stillman, Dennis M., 1949– II. Title.

RA971.3.P656 2004

362.1'068'1—dc22

2004014543

Printed in the United States of America

FIRST EDITION

HB Printing 10 9 8 7 6 5 4 3 2 1

# CONTENTS

List of Exhibits	xi
Foreword	xv
Preface	xvii
About the Authors	xxiii
<b>1 Governing</b>	<b>1</b>
Obligations	2
Responsibilities	3
Roles	6
Governance Work	8
Governance "Enablers"	9
In the Boardroom	10
<b>2 Financial Responsibilities</b>	<b>11</b>
Objectives	13
Plans	15
Monitoring and Assessing	15
Controls and the Audit	16
Organization	16
In the Boardroom	17
<b>3 Health Care Industry Financial Structure and Dynamics</b>	<b>19</b>
The Big Picture	20



Health Insurance	23
Voluntary Health Insurance	24
Social Insurance (Medicare)	26
Welfare Insurance (Medicaid)	28
Health Maintenance Organizations	28
<b>4 Accounting Basics</b>	<b>31</b>
Accounting Principles	32
Accounting Entity	32
Accounting Period	33
Monetary Unit	34
Objectivity	34
Accrual Accounting	34
Materiality	35
Full Disclosure and Transparency	35
Conservatism, Consistency, and Comparability	35
Accounting Value	36
Accounting Equation	36
Revenues	38
Expenses	38
Summary	40
<b>5 Reading Financial Statements</b>	<b>43</b>
Revenue/Expense Summary	44
Balance Sheet	48
Statement of Cash Flows	54
In the Boardroom	56
<b>6 Analyzing Financial Statements and Overseeing Financial Performance</b>	<b>59</b>
Horizontal and Vertical Analyses	62
Ratio Analysis	65
Financial Oversight	76
In the Boardroom	79

<b>7</b>	<b>Looking Forward: Vision, Strategies, Financial Plans, and Budgets</b>	<b>81</b>
	The Vision and Strategic Planning	82
	Financial Planning	87
	Budgeting	93
	In the Boardroom	95
<b>8</b>	<b>Source of Funds: Financing</b>	<b>97</b>
	Capital Structure	98
	Creditworthiness	100
	Long-Term Debt Financing	103
	In the Boardroom	108
<b>9</b>	<b>Use of Funds: Capital Investment</b>	<b>111</b>
	Approaches	113
	Types of Capital Investment	114
	Financial Analysis of Capital Projects	117
	In the Boardroom	124
<b>10</b>	<b>Financial Integrity and Credibility</b>	<b>127</b>
	Audit Committee	129
	The Audit	131
	Internal Controls	136
	Emerging Expectations and Standards	136
	In the Boardroom	138
<b>11</b>	<b>The Finale</b>	<b>141</b>
	Admonitions	141
	Checklist	149
	Resources	152
	 Appendix A: E. Polley Francis Hospital, Traditionally Configured Financial Statements	 157



Appendix B: Executive Summary of Sarbanes-Oxley Act Provisions and NYSE Governance Rules	163
Appendix C: E. Polley Francis Hospital, Illustrative Code-of-Conduct Provisions	171
Index	173

# LIST OF EXHIBITS

1.1	The Dimensions of Governance	2
1.2	Types of Board Policies	7
1.3	Governance Work	9
2.1	The Board's Responsibility for Finances: Key Components and Relationships	13
3.1	The U.S. Health Care Industry at a Glance	21
3.2	Distribution of Expenditures for Health Care Services	23
4.1	Depreciation	39
4.2	Illustrative Depreciation Calculation	40
4.3	Key Relationships	41
5.1	E. Polley Francis Hospital's Revenue/Expense Summary for Period Ending December 31, 2006	45
5.2	E. Polley Francis Hospital's Balance Sheet for December 31, 2006	49
5.3	The Balance Sheet at a Glance	54
5.4	E. Polley Francis Hospital's Statement of Cash Flows	55
6.1	E. Polley Francis Hospital's Revenue/Expense Summary for Years Ending 2006 and 2005	60



6.2	E. Polley Francis Hospital's Balance Sheet for December 31, 2006, and December 31, 2005	61
6.3	E. Polley Francis Hospital's Statement of Cash Flows for Years Ending December 31, 2006 and 2005	62
6.4	E. Polley Francis Hospital: Illustrative Horizontal Financial Statement Analysis	63
6.5	E. Polley Francis Hospital: Illustrative Vertical Financial Statement Analysis	64
6.6	E. Polley Francis Hospital: Illustrative Operating Statistics	74
6.7	Graphical Trend Analysis	75
6.8	Board Financial Performance Oversight Process	77
7.1	The Planning Cycle	82
7.2	The Vision	83
7.3	A Vision: E. Polley Francis Hospital, Illustrative Purposes, Values, and Goals	85
7.4	The Strategic Plan	86
7.5	Financial Needs and Capacities	89
7.6	The Needs and Capacity Aspects of Financial Planning	90
7.7	Exemplary Financial Plan: Components and Relationships	91
8.1	Bond Rating Categories and Scales	101
8.2	Bond Ratings: Selected Financial Ratios (U.S. Nonprofit Health Systems and Hospitals, 2003)	104
8.3	Distribution of Bond Ratings (U.S. Nonprofit Health Systems and Hospitals, 2003)	105

9.1	The Capital Cycle	112
9.2	Project Risk	116
9.3	Analytical Factors	117
9.4	Illustrative Cash Flows: Proposed Capital Project	119
9.5	Payback Analysis	121
9.6	Net Present Value Analysis Structure	122
9.7	Net Present Value Calculation	123
10.1	Illustrative Unqualified Audit Opinion Letter	133
10.2	Issues That Might Be Discussed with the Auditor in a Postaudit Conference	134
11.1	Illustrative Board Financial Calendar	144
A.1	E. Polley Francis Hospital Revenue and Expense Summary for the Year Ending December 31, 2006, by Natural Class of Expense	158
A.2	E. Polley Francis Hospital Revenue and Expense Summary for the Year Ending December 31, 2006, by Service	159
A.3	E. Polley Francis Hospital Balance Sheet, December 31, 2006	160
A.4	E. Polley Francis Hospital Statement of Cash Flows for the Year Ending December 31, 2006	161