THE HIGH COST OF GOVERNANCE DYSFUNCTION IN COMMUNITY HOSPITALS

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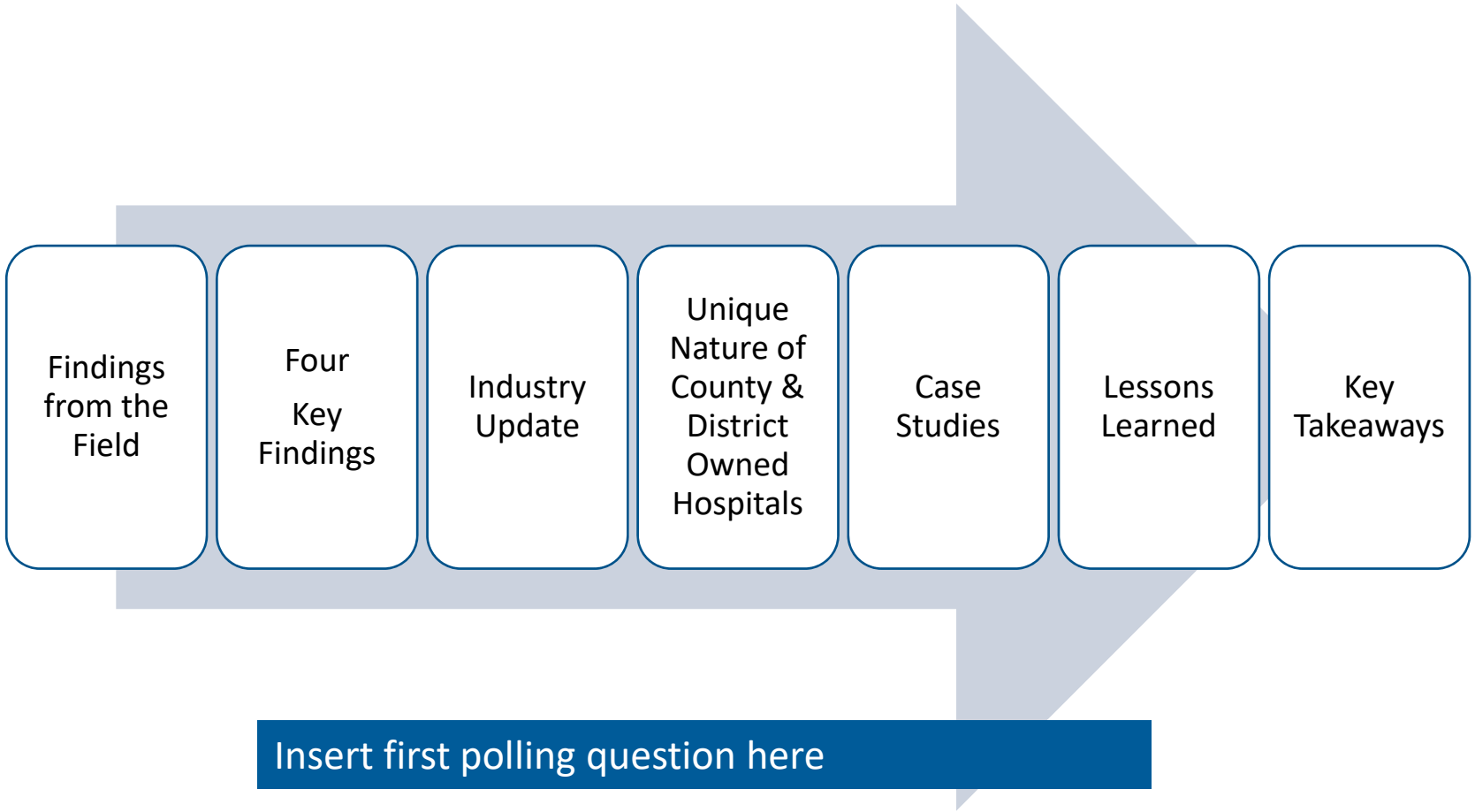
Agenda



Insert first polling question here

Amid the Pleasing Patter of Public Debate…

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Montrose Press

County and hospital to settle beefs

- By Katharhynn Heidelberg, Daily Press Senior Writer
- Feb 7, 2016

Gainesville Daily Register

Taxpayers will pay for hospital board's mistakes

- Jul 11, 2017

OPAQUE LEGAL STRUCTURE INCLUDES TWO BOARDS

http://www.thebanninginformer.com/

Red flag : Grand Jury finds that hospital cannot account for taxpayer dollars

The Hospital District operates in an opaque, difficult to understand legal structure. There is a public district, but also a 501,c, 3 , "Non-Profit" arm. According to the Grand Jury a total of two supervisory boards are exercising "oversight." These two boards and their correlation are difficult to understand, leading to "public confusion."

Heads High, Compassion Intact

A recent article in the Daily Sentinel detailed the "lengthy decline of [Memorial] hospital." A recent Daily Sentinel opinion piece claimed "Memorial Hospital's financial problems had been allowed to fester in the darkness or at least the shadows for far too long. Constituents of the hospital's governing board have the right to know so they can make informed choices at the ballot box."

MESSENGER

Hospital Board Addresses Community Concerns

Posted by Cheril Vernon | Jun 28, 2017 | Local News, News

4 Main Points – 4 Main Findings

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A Very Dynamic Healthcare Environment	• Essential to understand organizational risk profile and manage strategic risks • Risk profile changes have far reaching effects but can also go undiagnosed
Relationship Constraints	• Trust and communication as the essential currency • Develop a mechanism to forge trust
Common Fact Base and Shared Vision	• An updated common fact base and a shared vision are essential for finding common ground
Operating Performance	• Distractions from operating discipline are costly • Cash/cash flow are the lifeblood of any strategic vision

Industry Trends

Consumers Feel the Pain

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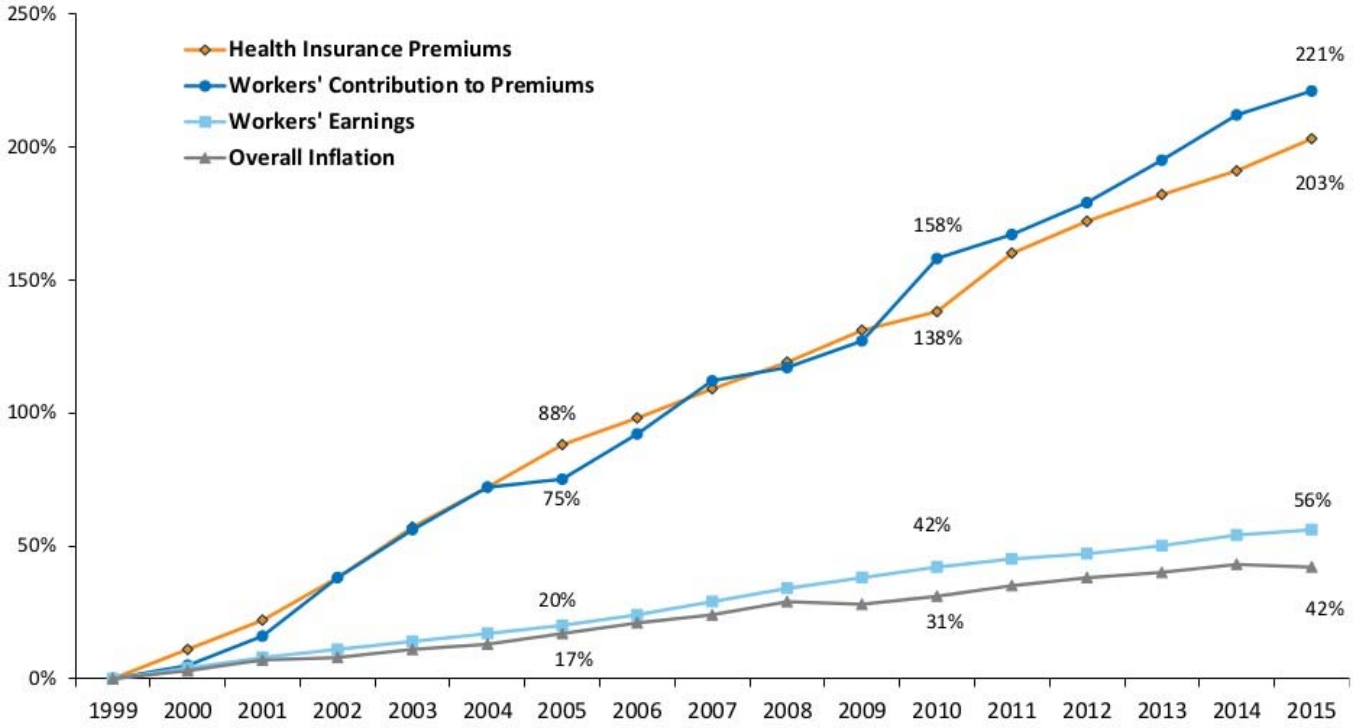
Cumulative Increases in Health Insurance Premiums, Workers' Contributions to Premiums, Inflation, and Workers' Earnings, 1999-2015



SOURCE: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2015. Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation (April to April), 1999-2015; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1999-2015 (April to April).

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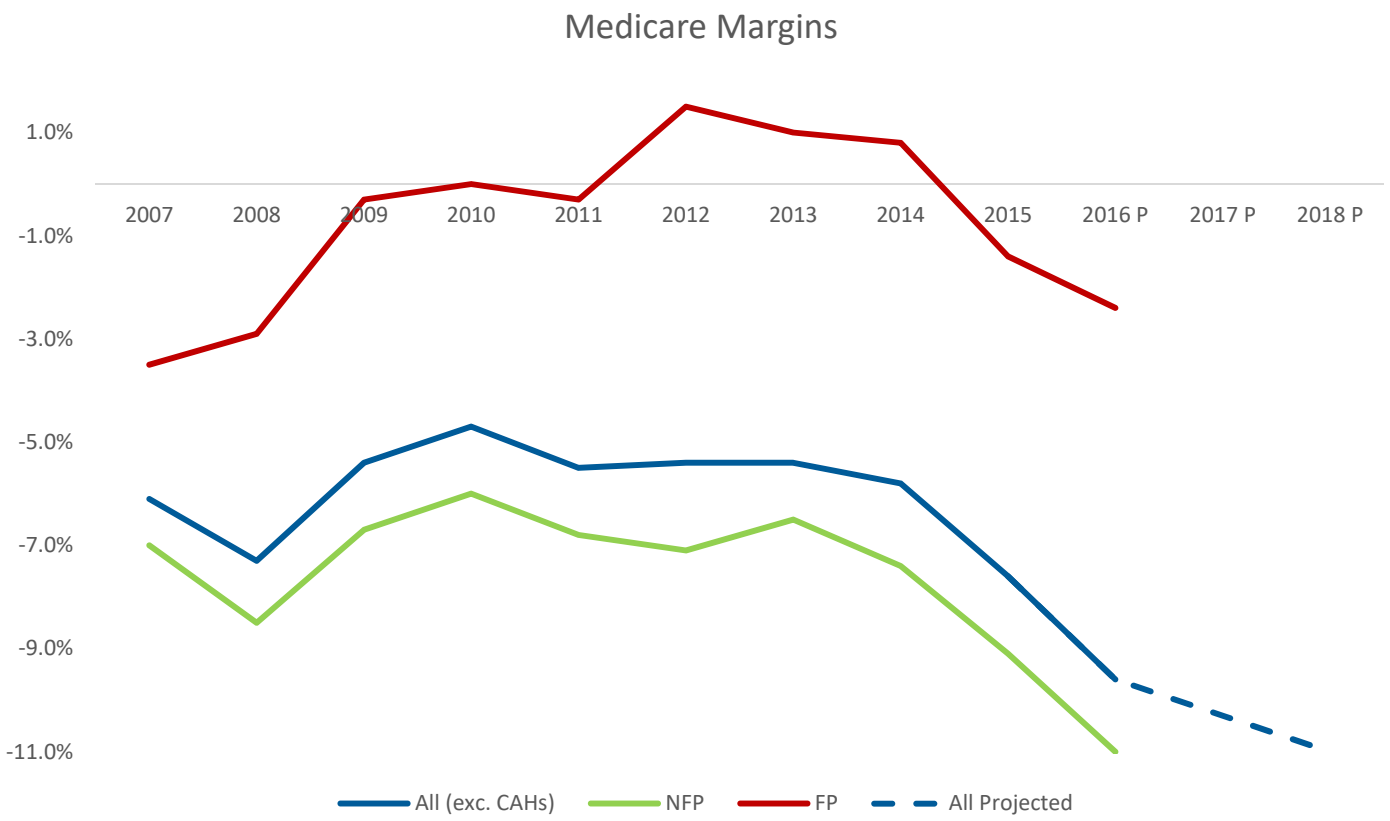
Source: Kaiser Family Foundation kff.org

Medicare Margins: US Hospitals



Medicare margins are expected to decline due to cessation of Meaningful Use funding and decreases in uncompensated care payments due to coverage expansion of ACA.

Source: MEDPAC

Negative Outlook for Nonprofit Hospitals in 2018

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MOODY'S INVESTORS SERVICE

- Moody's has revised the outlook for US not-for-profit and public healthcare to negative from stable based on the expectation that ***operating cash flow will contract by 2%-4%*** over the next 12-18 months.
- The inability of hospitals to translate volume growth into stronger revenue growth is due to the ***lower reimbursement rate increases across all insurance*** providers and higher expense growth.
    - ***Rising exposure to governmental payors*** will dampen revenue growth for the foreseeable future due to a rapidly aging US population and low reimbursement rates.
- Key drivers of expense growth include ***rising labor costs***, driven by ***an acute nursing shortage*** and ongoing ***physician and medical specialist hiring***.
- ***Technology costs*** are also rising as systems are upgraded and IT staff is needed for training and maintenance.
- While the ACA's arrival heralded a drop in "bad debt," ***unpaid hospital bills increased in 2017*** and will continue to grow at a rate of 6-7% in 2018.
    - *"**Rising copays and use of high deductible plans** will increase bad debt for both expansion and non-expansion states,"* Eva Bogaty, a Moody's Vice President says.

The Hospital Closure Epidemic

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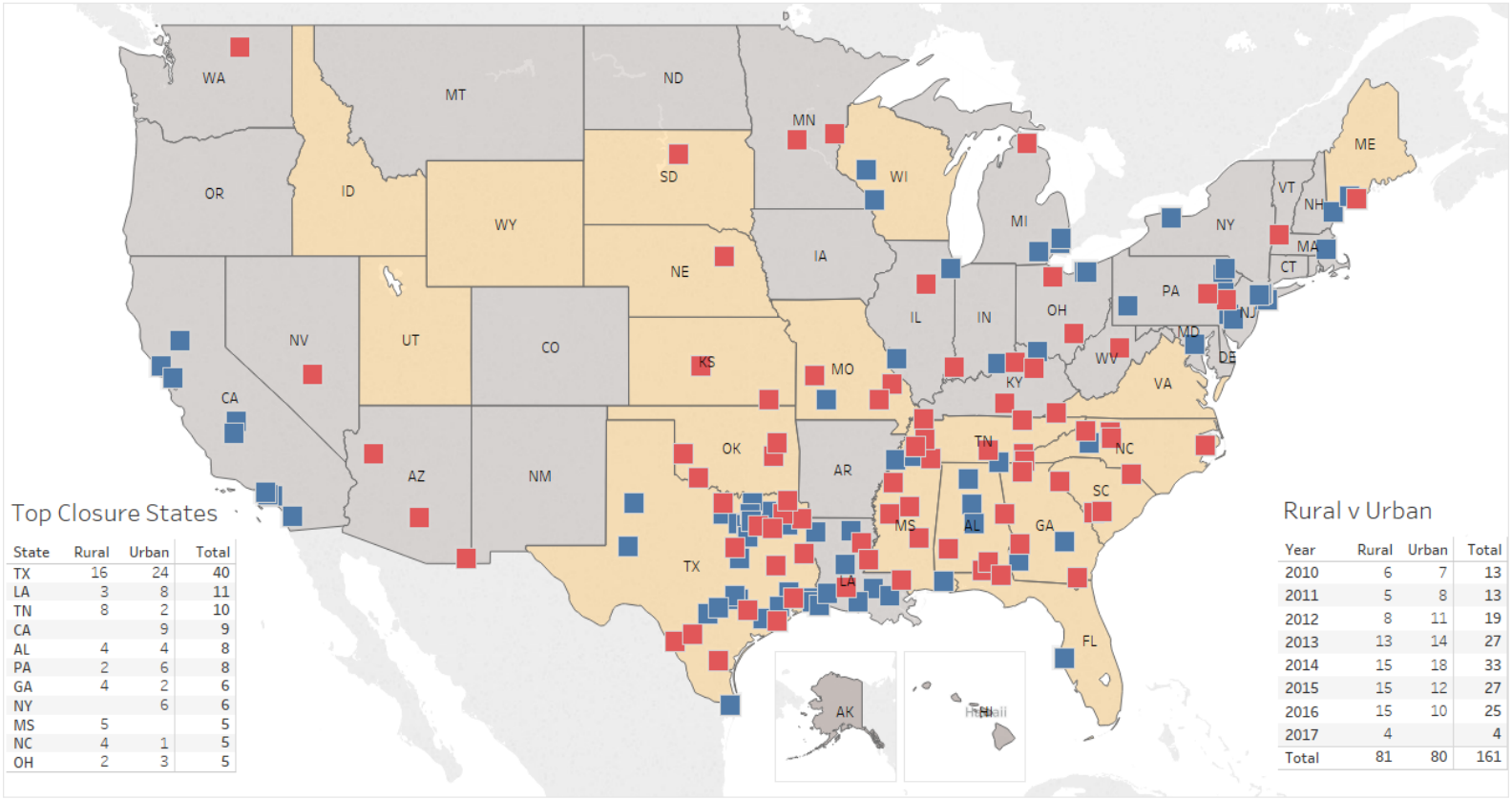
Rural and Urban Hospital Closures since 2010



Top Closure States

State	Rural	Urban	Total
TX	16	24	40
LA	3	8	11
TN	8	2	10
CA		9	9
AL	4	4	8
PA	2	6	8
GA	4	2	6
NY		6	6
MS	5		5
NC	4	1	5
OH	2	3	5

Rural v Urban

Year	Rural	Urban	Total
2010	6	7	13
2011	5	8	13
2012	8	11	19
2013	13	14	27
2014	15	18	33
2015	15	12	27
2016	15	10	25
2017	4		4
Total	81	80	161

Current Status of Medicaid Expansion Decision
- Adopted the Medicaid Expansion
- Not Adopting the Medicaid Expansion at this Time

Rural v Urban
- Rural
- Urban

Rural v Urban based on cost report designation

Sources: Cost Report data, The Cecil G. Sheps Center for Health Services Research, KFF.org

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Industry Consolidation

- Providers are aligning into regional hubs that provide scale and significant market presence
  - A common goal: achieving scale and turning it into a financial and competitive advantage
- New disruptive alignments pose new challenges to incumbents/existing business models:
  - CVS-Aetna
  - Optum-DaVita
  - Humana-Wal Mart
- Drivers behind consolidation and new combinations:
  - Financial pressures
  - Heightened competition / new competitors
  - Changing payment models: risk, value and high deductible health plans
  - Technological innovation
  - Declining inpatient admissions
  - Consumerism and value imperatives

Unique Nature of County & District Owned Hospitals

Unique Nature of County & District Owned Hospitals

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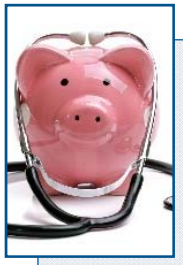
Multiple layers of governance and responsibility results in blurred lines of accountability

Political agendas, poor communication and lack of transparency can undermine effective board oversight functions

Public conflict dissuades talented and capable board nominees, providers and staff

•In some cases a government owned hospital system is not permitted to expand outside of the county/parish/district boundary



In some jurisdictions, authority-owned hospitals cannot file bankruptcy

County & District Owned Hospitals, continued

Subject to open meeting/sunshine laws

Tax support can mask actual financial and operational struggles of the hospital

Eroding operating performance creates financial exposure for tax payers and compromises a public asset

The County/District hospital is everyone's business: a complicated business and critical community resource becomes a source of division

Select Case Studies

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Western Community Hospital

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- 501c3 Board of County-owned hospital plans phased buildout of consolidated campus
- County Commissioners retain SA to assess feasibility of hospital's plan
- Initial phase: lots of infrastructure buildout plus inpatient heart center
    - Result: Hospital incurred additional debt service on necessary but non-revenue generating cap-ex; additional operating costs incurred by 24/7 heart center at new site
    - Depleted debt capacity and weaker than projected debt service coverage mean that hospital was stuck – Yikes!
- Hospital operations deteriorating – 501c3 blamed negative publicity stemming from County's meddling
    - A false narrative
- Hospital downgraded two notches (BBB- to BB+)
- After months long process and compelling evidence, 501c3 board capitulates – agrees that it lacks resources to execute plan on own
- The County-owned hospital selected a hospital operator to be its JV partner to fund both the replacement hospital campus and a community foundation

Southeast Community Hospital

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- Exposure to an unfunded long term liability created the need for county assistance
- The county agreed to issue debt on behalf of the hospital to fund the liability, pay off other long term debt and provide funding for needed capital expenditures
- Extensive communication between the county commission and the hospital authority board led to a cooperative initiative to improve the hospital's operating performance
- The hospital authority board and the county commissioners participated in a strategic options exercise that established a well documented common fact base, a path forward and a shared common vision
- The hospital was trending toward closure within six months. Nine months and several significant performance improvement initiatives later the hospital is still operating and turning the corner to positive financial performance
- The hospital is not "out of the woods" but cooperation between the two public entities created needed "run way" for the hospital to reverse its negative operating trends

Southern Coastal Medical Center

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- Relationship between Southern Coastal Hospital District/Southern Coastal Medical Center Board of Directors was historically divisive
- Intrusive and toxic local media where local “rabble rousers” could stir the pot
- Strong leadership at each level initiated the creation of a “Collaborative Committee” consisting of leadership of each board plus the medical center’s foundation board
- With the assistance of Stroudwater, the Collaborative Committee developed a common fact base and shared vision for the future
- Collaborative Committee put aside narrow agendas for a broader vision and solution for the future
- Implemented an effective communications plan and series of public meetings to provide updates and receive comments and feedback

Lessons Learned

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Sources of Conflict

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Triggering events that lead to and amplify dysfunction

- Eroding hospital operating performance
- Reductions to hospital services
- Contentious medical staff or employee issues
- Hospital board and management resist questions posed by elected officials
  - Management decisions are debated/second guessed by public officials
- Differing risk tolerances/perceptions of strategic risk held by hospital and county/district officials
- Personal agendas and histories drive board agendas and debate, driving away talented board members, providers and staff
- A lack of transparency, poor communication and personality conflicts all undermine the trust needed for effective county/district and hospital board oversight functions

NFP Board Functions and Blind Spots

The fiduciary duties of duty of care, duty of loyalty and duty of obedience for NFP boards should be applied to the primary functions below:

- Selecting, monitoring, evaluating, compensating and, if necessary, replacing the CEO
- **Defining, reevaluating and monitoring the long-term strategy by which the organization fulfills its mission**
- Approving budgets, financial plans and financial statements; reviewing and approving material capital allocations and expenditures; ensuring the integrity of the organization's financial reporting and processes; hiring the independent auditor (if any) and assuring itself of the auditor's independence
- ***Understanding the organization's risk profile and reviewing and overseeing the organization's management of risks***
- Ensuring compliance with all applicable laws, regulations, policies and ethical standards of the organization
- Establishing the composition of the board and its committees, and determining governance practices

Source: The Guide to Not-for-Profit Governance, Weil, Gotshal & Manges LLP

Evaluating & Mitigating Strategic Risk

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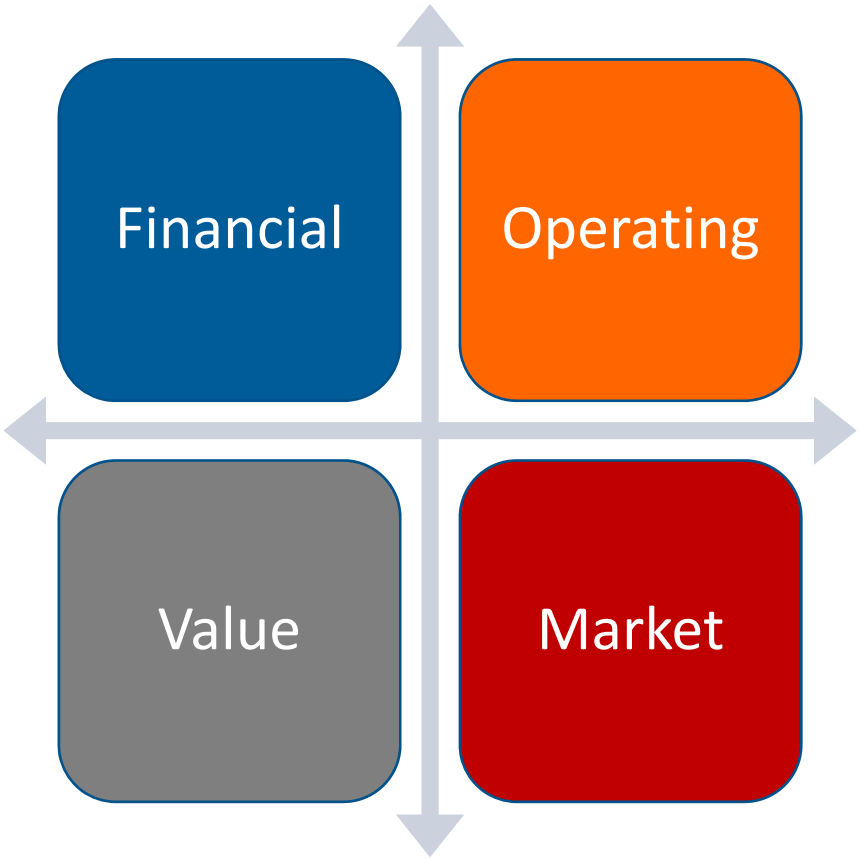

Many boards do not appreciate the cumulative effects of changes in risk factors that can take place over several years.

- The strategic risk profile for most hospitals and health systems is quite dynamic
- The four risk domains depicted to the left describe the major sources of strategic risk in today's environment
- Poor performance in one domain will have collateral or "spill over" effects on one or more of the other domains
- Key trends within each risk category should be monitored annually and long term trends quantified

Key Strategic Risk Indicators

Category	Indicators	Comments
Financial Risk Indicators	• Operating Revenue Trend • Operating Cash Flow & Cash Flow Margin • Debt Service Coverage • Operating Margin • Days Cash on Hand • Days in A/R	• Top line revenue growth is vital to long term health of organization • Operating Cash Flow & Cash Flow Margin are critical for DSCR covenant and investment
Operating Risk Indicators	• FTEs per AOB • Case Mix Index • Payer Mix • Key Volume Trends (O/P and I/P) • Practice Operations, Production and Losses • Revenue and Cost per Adjusted Patient Day	• FTEs per AOB key efficiency metrics • Payer mix and CMI indicate how well the organization is competing for sought after patient populations
Value Risk Indicators	• Cost Position • Attributed Covered Lives • Quality Scores • Performance at Managing Risk for ERISA, ACO and other Population Health vehicles • Retail pricing and charge variability	• Covered lives reflect key population health metric and move from fee for service • What is the organization's ability to manage the health status of populations
Market Risk Indicators	• Market Share Trends • Provider Alignment, Recruitment and Retention (vs. documented need; turnover, productivity) • Consumer Preference Research	• Market share is an indicator of how well the hospital is competing for patients and covered lives • Provider alignment is essential for attribution of covered lives

Best Practices to Addressing Conflict

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- **Board and stakeholder education**
  - National, regional and market forces
  - Organizational constraints and opportunities
  - Strategic risks facing hospital
  - Hallmarks of good governance and sound management
- **Develop a common fact base**
  - Quantify performance gaps
  - Understand risk factors
  - Develop strategic objectives
- **Convene a task force involving key leaders from both boards and/or key stakeholder groups**
  - Provide a format for communication and sharing of perspectives
  - Engage around key issues and concerns
  - Remove emotion and make objective data the basis for decisions
  - Develop working relationships and trust
  - Seek consensus vs. unanimity

Best Practices, Continued

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- **Develop a shared vision for the future**
  - What key attributes do board members want the organization to have in 5-10 years?
  - Engage boards and stakeholders around the shared vision
- **Develop and implement a communications strategy**
  - Develop key messages and talking points
  - Identify spokespeople
  - Emphasize the shared vision
  - Anticipate internal and external communication requirements
  - Repeat
- **Don't lose sight of the fundamentals**
  - Sound governance and management
  - Strategy
  - Operational performance

Thank You

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