

Nurses on Boards In Kansas:  
A Kansas Action Coalition  
Webinar Series

SESSION 2:  
FINANCE BASICS

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**OBJECTIVES**

By the end of this session, participants will be able to:

1. Distinguish three commonly used financial statements.
2. Explain how organizations can use financial ratios as key metrics of organizational performance.
3. Describe the budgeting process and the use of variance reports.
4. Identify additional reports that board members typically review.

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OVERVIEW

Financial Literacy  
for Board  
Membership

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## HEALTH CARE ECONOMICS 101

- US annual healthcare expenditures
  - exceeded \$3 trillion, which is \$9,523 per person (CMS, 2014)
  - 17.5% of GDP (World Bank, n.d.)
- Where does the \$3 trillion go? According to CMS (2014),
  - Hospitals (32%)
  - Physicians and clinical services (20%)
  - Retail outlet sales of prescription drugs (10%)
  - Providers of other health, residential, and personal care (5%)
  - Nursing care facilities and continuing care retirement communities (5%)
  - Dental services (4%)
  - Providers of home health care (3%)
  - Government public health services (3%)

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## WHO BEARS THIS COST?

- Major sources of reimbursement for HC providers are (CMS, 2014):
  - Medicare (20%),
  - Medicaid (16%),
  - Private health insurance (33%), and
  - Out of pocket (11%).
- The US uninsured rate was a record low 11.0% in May 2016. It has declined over 6 percentage points since 2014 when the individual mandate provision of the Affordable Care Act took effect (Marken, 2016).
- The cost of uninsured patients is borne first by the patient (if they can afford it), then by the health care provider (through either charity care or uncompensated care).

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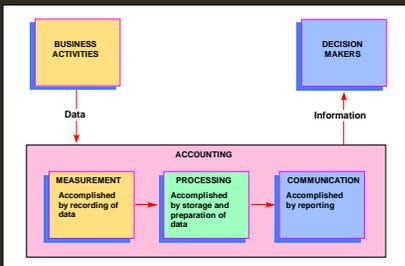
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**OVERVIEW** | Financial Accounting

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### FINANCIAL ACCOUNTING

- A branch of accounting primarily concerned with the preparation of financial statements for external users.
- Governed by rules and requirements known as generally accepted accounting principles (GAAP)
- Sources of GAAP include:
  - Financial Accounting Standards Board (FASB)
  - American Institute of CPAs (AICPA)
  - US Securities and Exchange Commission (SEC)
  - International Accounting Standards Board (IASB)

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### PRIMARY OUTPUTS OF FINANCIAL ACCOUNTING

- Three primary statements:
  - Balance Sheet
  - Statement of Operations (a.k.a., Income Statement or Profit and Loss Statement)
  - Statement of Cash Flows
- Footnotes to the Financial Statements: Narrative information that supplements the financial statements and provides additional details and clarity.

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## SCOPE OF BUSINESS AND DATE(S)

Financial statements are produced for a specific accounting entity (a single organization or group of organizations).

- The reader of financial statements should clearly understand which accounting entity the statements address and the date or reported period of each statement.
- This information is identified at the top of each statement.

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## STATEMENT OF OPERATIONS (A.K.A., INCOME STATEMENT OR PROFIT AND LOSS STATEMENT)

HUNTER COMPANY Income Statement For the Year Ending December 31, 2019	
<b>Revenues</b>	
Net sales	\$613,000
<b>Expenses and losses</b>	
Cost of goods sold	\$201,000
Selling expenses	140,000
General & administrative	175,000
Loss on sale of land	2,000
Interest expense	7,000
	<u>625,000</u>
<b>Income before tax</b>	\$ 88,000
Income tax expense	<u>10,000</u>
<b>Net income</b>	<u>\$ 78,000</u>

Presents a summary of revenues and expenses over a period of time.

The difference is nicknamed “the bottom line,” a.k.a., net income (or net loss).

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## GAAP REQUIREMENTS

- Revenues (a.k.a., sales) are reported as they are earned.
- Expenses are reported as they are used.
- Revenues and expenses are matched to determine profits (a.k.a., net income or net loss) during the reporting period.
- Remember that (\$5,000) indicates a net loss of \$5,000

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# THE BALANCE SHEET

(A.K.A., STATEMENT OF FINANCIAL POSITION)

Financial Position at a Point in Time



• A snapshot



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# THE BALANCE SHEET

Has 2 major sections:

- Assets
- Information about how those assets are financed (either through debt or equity)

Balance Sheet		
As of Dec. 31, 2004 (000's)		
	2004	2003
<b>Assets</b>		
Cash and Equivalents	52,000	57,000
Accounts Receivable	462,000	351,200
Inventory	836,000	715,200
<b>Total Current Assets</b>	<b>1,350,000</b>	<b>1,123,400</b>
Plant & Equipment	527,000	491,000
Accumulated Depreciation	(166,200)	(185,200)
<b>Net Fixed Assets</b>	<b>360,800</b>	<b>305,800</b>
<b>Total Assets</b>	<b>1,710,800</b>	<b>1,429,200</b>
<b>Liabilities and Owner's Equity</b>		
Accounts Payable	175,200	145,000
Short-term Notes Payable	225,000	200,000
Other Current Liabilities	140,000	136,000
<b>Total Current Liabilities</b>	<b>540,200</b>	<b>481,000</b>
Long-term Debt	454,612	323,432
<b>Total Liabilities</b>	<b>994,812</b>	<b>804,432</b>
Common Stock	400,000	400,000
Retained Earnings	315,988	223,768
<b>Total Shareholders' Equity</b>	<b>715,988</b>	<b>623,768</b>
<b>Total Liabilities and Owner's Equity</b>	<b>1,710,800</b>	<b>1,429,200</b>

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# THE BALANCE SHEET

The balance sheet will always balance using the formula below:

$$\text{Total Assets} = \text{Total Liabilities} + \text{Residual Interest}$$



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## CURRENT & NON-CURRENT ASSETS

### Current Assets:

- Cash and cash equivalents
- Patient accounts receivable
- Estimated third-party payer settlements
- Supplies
- Other current assets

### Non-current Assets

- Long-term investments
- Property and equipment
- Other non-current assets

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## CURRENT & NON-CURRENT LIABILITIES

### Current Liabilities:

- Current installments of long-term debt
- Accounts payable
- Accrued expenses
- Construction payable
- Estimated third-party settlements
- Deferred revenue

### Non-current Liabilities

- Long-term debt
- Deferred revenue
- Estimated malpractice costs

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## RESIDUAL INTEREST

For Profit

Not for Profit

Shareholders' Equity	Net Assets
<ul style="list-style-type: none"> <li>• Common stock</li> <li>• Additional paid in capital</li> <li>• Retained earnings</li> </ul>	<ul style="list-style-type: none"> <li>• Unrestricted</li> <li>• Temporarily restricted</li> <li>• Permanently restricted</li> </ul>

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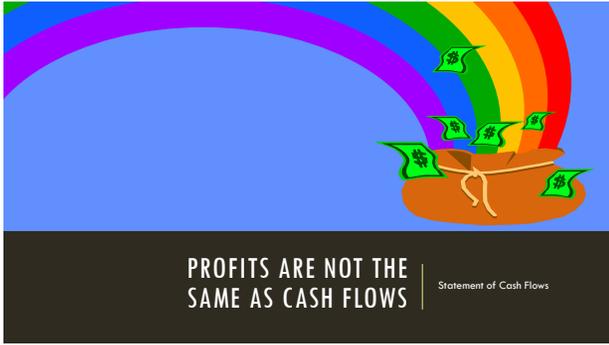
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### STATEMENT OF CASH FLOWS

- Provides information on the flow of funds (where it came from and where it went)
- Reports cash flow from the following activities:
  - Operating
  - Investing
  - Financing

All figures in USD	
<b>Cash Flow From Operations</b>	
Net Earnings	2,000,000
<b>Adjustments to Cash</b>	
Depreciation	10,000
Decrease in Accounts Receivable	15,000
Increase in Accounts Payable	15,000
Increase in Taxes Payable	2,000
Subtraction from Cash	
Increase in Inventory	(50,000)
<b>Total Cash from Operations</b>	<b>2,012,000</b>
<b>Cash Flow From Investing</b>	
Equipment	(600,000)
<b>Cash Flow From Financing</b>	
Notes Payable	10,000
<b>Cash Flow for FY Ended 31 Dec 2003</b>	<b>1,522,000</b>

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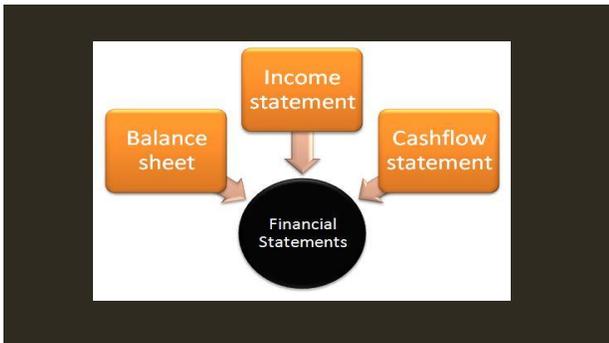
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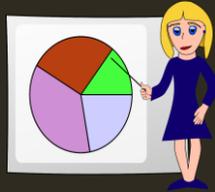
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## FINANCIAL INFORMATION



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## RATIO ANALYSIS

An approach to analyzing the financial condition of an organization using ratios calculated from line items found in the financial statements.

Four major categories of ratios:

- Profitability
- Activity (a.k.a., efficiency ratios)
- Capital structure (a.k.a. capitalization ratios)
- Liquidity

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## PROFITABILITY RATIOS

Answer the question: How profitable is the organization?

Examples:

- Return on Assets (net income/total assets) measures the rate of return on each dollar of assets
- Return on Equity (net income/equity) measures the rate of return for each dollar of equity
- Profit Margin (net income/net revenue) measures the percentage of each revenue dollar that is left after subtracting expenses.

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## ACTIVITY RATIOS (A.K.A. EFFICIENCY RATIOS)

Answer the question: How efficiently is the organization using its assets?

Examples:

- **Asset Turnover (net operating revenue/total assets):** measures the amount of revenue generated for every dollar of assets
- **Fixed-asset Turnover Ratio (total revenues/net plant and equipment):** an indicator of capital intensity; measures the amount of revenue generated for each dollar invested in plant and equipment.

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## CAPITAL STRUCTURE RATIOS (A.K.A., FINANCIAL LEVERAGE RATIOS)

Answer the question: What is the organizations debt position?

Examples:

- **Equity Financing Ratio (equity/total assets):** measures the percentage of assets financed by equity.
- **Debt Financing Ratio (total debt/total assets):** measures the percentage of assets financed by debt.
- **Long-term debt to equity ratio (long-term debt/equity):** measures the amount of long-term debt for every dollar of equity.

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## LIQUIDITY RATIOS

Answer the question: How able is the organization to meet its maturing obligations with its current assets?

Examples:

- **Current Ratio (current assets/current liabilities):** measures an organization's ability to pay off its short-term obligations with its current assets.
- **Quick Ratio (current assets less inventories/current liabilities):** measures an organization's ability to pay off its short-term obligations with its most liquid assets.

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## BENCHMARKING WITH RATIOS

- Financial ratios are not very useful unless they are benchmarked against something.
- Ratios are compared to:
  - Industry averages (or relevant comparison group averages)
  - The organization's past performance (trend analysis)
  - Organizational goals or targets (approved by the board)

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## LIMITATIONS OF RATIO ANALYSIS

- Assets are valued at historic (i.e., acquisition) costs (a.k.a., book value). Distortions can occur during periods of high inflation.
- The answer to "What is a good ratio?" is not always clear. Is the industry average a desirable target?
- Specific ratio comparisons might be affected by
  - Varied accounting practices
  - Seasonality
  - Age of the facilities
  - Multiple lines of business

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## POINTS TO REMEMBER

- There are numerous ratios within a category that can be used to help answer the question being asked by a ratio category.
- No one ratio in a category is necessarily better than the others. Each tells you something different.
- It is better to use more than one ratio in each category.

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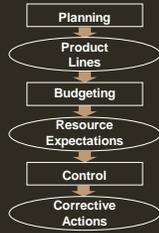
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## PLANNING, BUDGETING, AND CONTROL



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## VARIANCE REPORTS

- Monthly and/or yearly.
- Compare actual revenues and expenses with budgeted revenues and expenses.
- Annual variance reports allow board members to gauge how effective managers were in predicting revenues and controlling the utilization of resources in the prior year.



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## PREPARATION OF THE BUDGET

1. **Statistics Budget** – Identifies the amount of services that management expects will be provided during the budget period (by type of service, payor, and intensity)
2. **Revenue Budget** – Forecasts the operating and non-operating revenues that will be earned during the budget period
3. **Expense Budget** – Forecasts operating and non-operating expenses during the budget period

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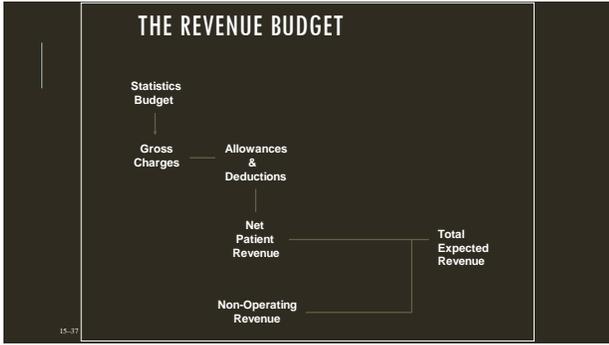
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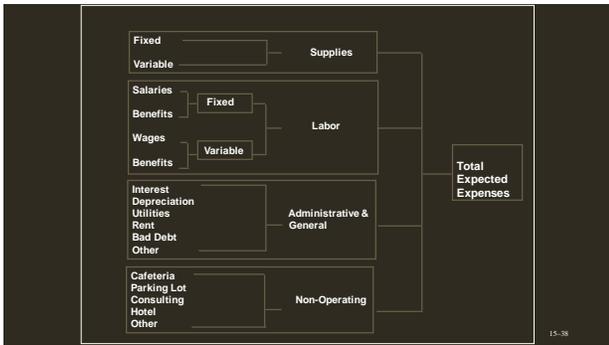
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### THE BUDGET

- Is the central document of the planning/control cycle
- Is a communication tool
- a "quantitative expression of a plan of action"
- Is stated in monetary (\$\$\$) terms
- Translates program decisions into terms that are meaningful for relevant managers
- Covers a period of 1 year
- May highlight problems related to the financial feasibility of decisions and prompt reevaluation of those decisions

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## KEY QUESTIONS ADDRESSED IN BUDGETS

### What and Why?

- What do you want to do?
- Why? Justification

### How?

- What services are we going to offer?
- To whom?
- With what resources?]

### How much will it cost?

Where will the money come from?



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## AUDITS AND INTERNAL CONTROLS

- **Review of Audit Reports:** Internal (and perhaps external) audits should be completed on an annual basis. If an external auditor is chosen, the board selects, monitors, and evaluates the external auditor.
- **Review of Internal Controls:** In addition to completing an external audit, auditors often evaluate the sufficiency of internal controls to ensure that financial processes are ethical and in compliance with laws, regulations, and best practices.

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## TAX EXEMPT ORGANIZATIONS

Boards of tax exempt organizations should

- Receive verification of timely and accurate filing of IRS Form 990 and other required reports on an annual basis.
- Review annual report of benefits that quantify the value the organization provides to the community. Benefits often include things like free screenings, free or uncompensated care, flu shot clinics, free presentations by employees, and other products or services.

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## DIRECTORS & OFFICERS INSURANCE COVERAGE

Many organizations protect their directors and officers through the purchase of D & O Insurance Coverage. If your organization does not have an existing policy, you might want to suggest they purchase one.

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## CONCLUSIONS

- Every board member needs to have a certain level of financial literacy.
- Many organizations offer training sessions for new board members to help them gain the skills they need to be effective in their new role.
- Financial statements provide important information about assets, liabilities, equity or net assets, profitability, and cash flows.
- Financial ratios may be benchmarked against industry averages, past performance, and/or organizational goals or targets.
- The board plays an active role in both strategic planning and financial planning.

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## FUTURE SESSION

### SESSION 3:

- In July
- More information will be forthcoming soon.

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## QUESTIONS?




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