Using *All* the Information You Need for Success

Financial reporting systems alone aren't enough to get you through today's tough times

BY KEVIN R. MADDRON, CPA

Senior housing and care providers over the last five years have been faced with a myriad of operational issues impacting the profitability of their organizations. Specifically, changes in reimbursement methodologies, increasing competition from new and existing providers in heavily saturated markets, newly enacted government legislation, and an inability to find qualified and affordable personnel have resulted in increased operating costs and declining profit margins. Providers find that raising monthly service fees or obtaining additional reimbursement to maintain operating performance is not an option.

To remain competitive and profitable, providers need to analyze their cost structures and business processes. Performance measurement techniques can identify those business processes that need refinement and uncover ways to improve operating cash flow.

Performance measurement is not a new concept. Until recently, however, its use in the senior housing and care arena has been limited. Historically, providers who offered varying levels of services and amenities believed that their operations were unique and lacked comparability to their peers. Also, the provider's source of revenue (i.e., for-profit vs not-for-profit and the extent to which they rely on government programs for reimbursement) have been perceived as impacting the level and costs of services offered, and thus overall results of operations. In addition, the lack of disclosure and sharing of financial information by providers has made performance measurement a difficult undertaking, often yielding unreliable or misleading results. Finally, many providers have relied on increasing monthly service fees to offset rising costs, and have, therefore, not been proactive in evaluating their business processes.

Performance measurement, if used properly, should combine financial and *nonfinancial* indicators to tell the story of how well a provider is doing today and has positioned itself for the future. Financial indicators can be thought of as grades on a report card; they measure the outcomes of past decisions or events and address the overall health of the organization at a particular point in time. Because they focus on past events, they are commonly referred to as "lagging indicators." To be more effective, financial indicators should be compared to expected outcomes, typically those found in an organization's business plan. In other words, financial indicators should demonstrate trends and patterns in performance over time.

Nonfinancial indicators, which are frequently overlooked, can help to uncover the root causes of an organization's successes and shortcomings. Often referred to as "leading indicators," they address the factors that impact financial performance and provide the framework for strategic planning and decision making. Understanding and monitoring nonfinancial indicators can allow a provider to take advantage of changes in the marketplace more quickly—before they negatively impact financial statements. (See the Table for common performance measurement indicators.)

Benchmarks and Industry Best Practices

The use of benchmarks and comparison to industry-accepted "best practices" are an integral part of the performance measurement process. Benchmarks are points of reference from which meaningful comparisons can be made. Typical sources include industry averages and operating capacities. The use of "best practices" identifies providers who outperform their peers by setting performance expectations at a level consistent with those of the best providers.

To do this, management determines which benchmark or "best practices" measure to use in light of its particular mission, goals and objectives. Benchmarks for a not-for-profit skilled nursing provider serving a rural community would be very different from those for a for-profit provider delivering the same services in a continuing care retirement community. Determining which benchmarks are appropriate and then gathering the relevant information are essential to obtaining the full benefits that benchmarking provides.

Invaluable to senior housing and care providers in today's environment, benchmarking identifies key external factors affecting their operations. These would include technologic improvements in care of the elderly, pending and newly enacted legislation, shifts in consumer preferences and demands, and changes in the legal and economic environment. They often require management to revise certain assumptions critical to their community's success, such as changing the mix and size of resident units or the amount and level of services provided. Additionally, reviewing the competitive environment highlights opportunities for an organization to grow new lines of business or divest itself of less profitable ones.

Today, new information sources are available for benchmarking comparisons. National and state associations for senior housing and care providers publish financial ratios, trends and operational statistics for the industry. Industry consultants and rating agencies have accumulated information obtained from provider financial statements, surveys and government agencies. By using data such as these and focused market-area research, the organization will produce a perfor-

Table. Common Performance Measurement Indicators.

Financial	**Nonfinancial**
Performance Measures	*Occupancy Measures*
Operating margin	Percent of units occupied
Operating ratio	Annual resident turnover
Total margin	Move-in and move-out rates
Earnings before interest, taxes, depreciation and amortization	Qualified marketing leads to closed sales ratio
Per resident day/unit statistics	Waiting lists
Liquidity Measures	*Operating Measures*
Net days in accounts receivable	Number of FTEs per resident
Days' cash on hand	Number of FTEs by department
Average days in current liabilities	Number of meals served
Cushion ratio	Staff retention ratio
Capital and Cash-Flow Measures	*Quality Measures*
Debt service coverage ratio	Resident satisfaction surveys
Debt service as a percentage of revenues	Quality-of-care surveys
Cash-to-debt ratio	*Property Measures*
Debt-to-assets ratio	Average age of buildings
Debt-to-capitalization ratio	

mance measurement report that identifies market needs promising additional revenues, redefines business processes to reduce operating costs and equips management with the knowledge necessary to outperform the competition and remain profitable in difficult times.

Case Study: Performance Measurement in Action

In 1997, a 120-bed nonprofit skilled nursing provider built a replacement facility and added a 60-unit assisted living facility to its campus. Tax-exempt bonds financed the construction, and the provisions of the loan agreement required compliance with certain liquidity, profitability and occupancy targets on a quarterly and annual basis. During the initial fill-up phase and at stabilized occupancy, the provider met its occupancy targets, but did not meet the debt service coverage ratio and days' cash on hand requirements. By missing these mandatory covenants, the provider faced a loan agreement that required a corrective action plan to achieve compliance in a reasonable amount of time.

Until this point, management had been using a reporting system that compared monthly and year-to-date results to those of the prior year and to the current year's budget. Often, the data were several months old by the time they were reviewed by management, and the budgeted numbers were not revised for changes in external factors. This monitoring and reporting system was not effective in communicating the problems behind the numbers.

A performance measurement report, however, highlighted the cause of the operating problems, given that occupancy targets were being met. The corrective action plan therefore addressed the following questions:

- Were the business plan assumptions used to obtain financing realized?
- How did the monthly service fees and patient mix compare to the assumptions in the business plan? Had anything changed in the marketplace that would require a revision to those assumptions?
- Was the community staffed appropriately for services provided in both the skilled nursing and assisted living components?
- How effectively was the provider managing its receivables and cash flow?
- How was the provider performing in comparison to industry benchmarks and to similar providers in the market area?

As a basis for a new business plan, the performance measurement report used financial and nonfinancial indicators to identify operational inefficiencies. Comparisons with benchmarks for staffing patterns indicated that full-time equivalent (FTE) employees for administrative and dietary positions were well above industry norms. The provider's state

Agency for Health Care Administration published on its Web site resident-care staffing levels for similar skilled nursing care providers in the area, based on recent surveys. These numbers and industry benchmarks, when compared with the provider's, showed that the provider's resident-care staffing patterns and pay rates were not outside acceptable ranges—a sensitive issue with management. Further analysis indicated that the monthly fee structure for assisted living services could be increased, yet still allow the provider to maintain an image as one that catered to persons of lower and middle incomes.

The corrective action plan using financial and nonfinancial indicators, as well as industry and market-area benchmarks, focused management's efforts on restoring financial health and accountability. The result was a revised business strategy, with measurable goals to monitor performance, consensus building and accountability within the organization, and improved feedback to those responsible for achieving goals. After revising its reporting and monitoring system, the organization's operations and cash flow improved and, more importantly, could be measured and monitored against the corrective action plan.

Final Thoughts

Do you know what drives financial performance in your organization? Are users of your financial reports getting the information they need to make informed decisions? If your current reporting system fails to look beyond the numbers on a financial statement, an effective performance measurement system is the answer. Providers that use such a system as part of long-term strategic planning are more likely to achieve and fulfill their mission and purpose.

The good news is that industry benchmarks are now widely available to measure performance. Moreover, financial statement users universally recognize industry-based financial and nonfinancial indicators as critical measurement tools for evaluating the overall health of a provider organization. Taking a proactive approach such as this will allow you to create your outcomes, rather than simply report them, and this will ensure your best opportunity for success during turbulent times. **NH**

Kevin R. Maddron, CPA, is healthcare manager with Moore Stephens Lovelace, PA, an accounting and financial management firm based in Winter Park, Florida. For further information, phone (407) 740-5400, fax (407) 740-0012 or e-mail krm1@ms-lovelace.com.