CHAPTER 2

Four Things the Healthcare Manager Needs to Know About Financial Management Systems

Progress Notes

After completing this chapter, you should be able to

1. Understand that four segments make a financial management system work.
2. Follow an information flow.
3. Recognize the basic system elements.
4. Follow the annual management cycle.

WHAT DOES THE MANAGER NEED TO KNOW?

Financial management is both an art and a science. You, as a manager, need to perceive the structure and reasoning that underlies management actions. To do so, you need to be able to answer the following four questions:

1. What are the four segments that make a financial management system work?
2. How does the information flow?
3. What are the basic system elements?
4. What is the annual management cycle for reporting results?

This chapter provides answers to each of these four questions. It also discusses how to communicate financial information to others. This ability is a valuable skill for a successful manager.

HOW THE SYSTEM WORKS IN HEALTH CARE

The information that you, as a manager, work with is only one part of an overall system. To understand financial management, it is essential to recognize the overall system in which your organization operates. An order exists within the system, and it is generally up to you to find that order. Watch for how the information fits together. The four segments that make a healthcare financial system work are (1) the original records, (2) the information system, (3) the accounting system, (4) and the reporting system. Generally speaking, the original records provide evidence that some event has occurred; the information system gathers this evidence; the accounting system records the evidence; and the reporting system produces reports

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of the effect. The healthcare manager needs to know that these separate elements exist and that they work together for an end result.

THE INFORMATION FLOW

Structure of the Information System

Information systems can be simplistic or highly complex. They can be fully automated or semi-automated. Occasionally—even today—they can still be generated by hand and not by computer. (This last instance is becoming rare and can happen today only in certain small and relatively isolated healthcare organizations that are not yet required to electronically submit their billings.)

We will examine a particular information system and point out the basics that a manager should be able to recognize. **Figure 2–1** shows information system components for an ambulatory care setting. This complex system uses a clinical and financial data repository; in other words, both clinical and financial data are fed into the same system. An automated medical record is also linked to the system. These are basic facts that a manager should recognize about this ambulatory information system.

In addition, the financial information, both outpatient and any relevant inpatient, is fed into the data repository. Scheduling-system data also enter the data repository, along with any relevant inpatient care plan and nursing information. Again, all of these are basic facts that a manager should recognize about this ambulatory care information system.

These items have all been inputs. One output from the clinical and financial data repository (also shown in Figure 2–1) is insurance verification for patients through an electronic data
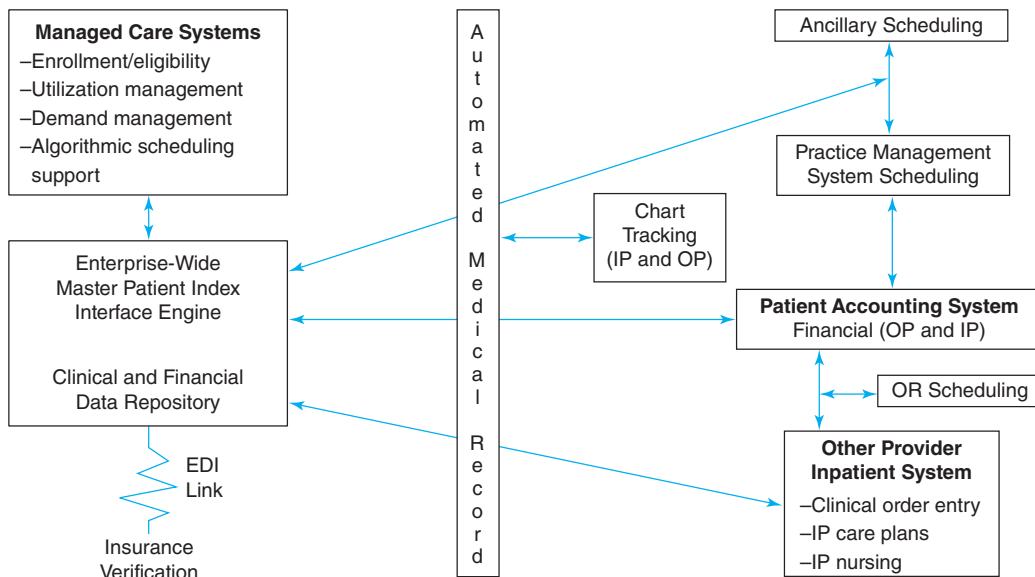

Figure 2–1 Information System Components for an Ambulatory Care Setting.
OP, Outpatient; IP, Inpatient; OR, Operating Room.

information (EDI) link to insurance company databases. Insurance verification is daily operating information. Another output is decision-making information for managed care strategic planning, including support for demand, utilization, enrollment, and eligibility, plus some statistical support. The manager does not have to understand the specifics of all the inputs and outputs of this complex system, but he or she should recognize that these outputs occur when this ambulatory system is activated.

Function of Flowsheets

Flowsheets illustrate, as in this case, the flow of activities that capture information.[1] Flowsheets are useful because they portray who is responsible for what piece of information as it enters the system. The manager needs to realize the significance of such information. We give, as an example, obtaining confirmation of a patient's correct address. The manager should know that a correct address for a patient is vital to the smooth operation of the system. An incorrect address will, for example, cause the billing to be rejected. Understanding this connection between deficient data (e.g., a bad address) and the consequences (the bill will be rejected by the payer and thus not be paid) illustrates the essence of good financial management knowledge.

We can examine two examples of patient information flows. The first, shown in **Figure 2–2**, is a physician's office flowsheet for address confirmation. Four different personnel are involved, in addition to the patient. This physician has computed the cost of a bad address as $12.30 to track down each address correction. He pays close attention to the handling of this information because he knows there is a direct financial management consequence in his operation.
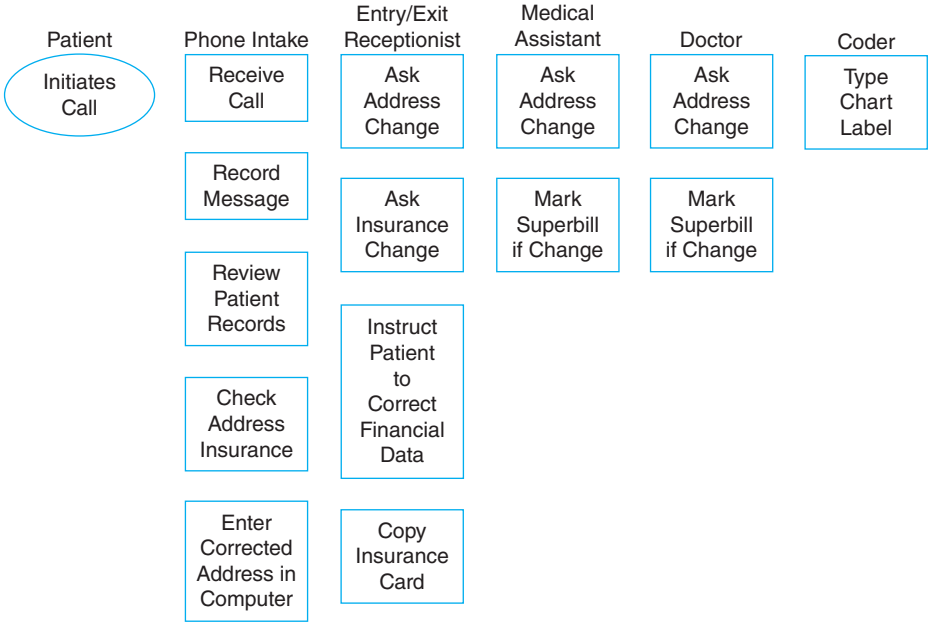

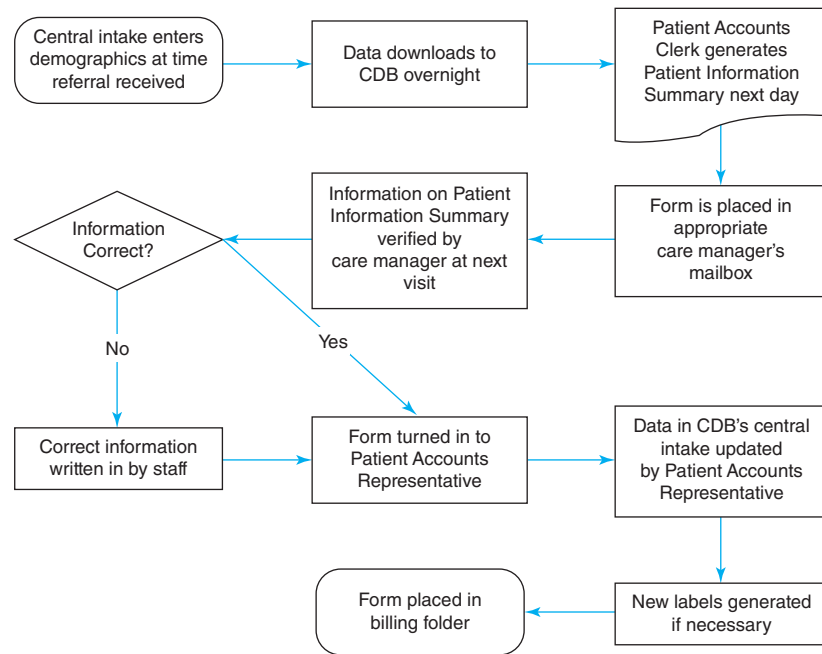**Figure 2–2** Physician's Office Flowsheet for Address Confirmation.

Figure 2–3 Health System Flowsheet for Verification of Patient Information.

The second example, shown in **Figure 2–3**, is a health system flowsheet for verification of patient information. This flowsheet illustrates the process for a home care system. In this case, the flow begins not with a receptionist, as in the physician office example, but with a central database. This central database downloads the information and generates a summary report to be reviewed the next day. Appropriate verification is then made in a series of steps, and any necessary corrections are made before the form goes to the billing department. The object of the flow is the same in both examples: that is, the billing department must have a correct address to receive payment. But the flow is different within two different systems. A manager must understand how the system works to understand the consequences—then good financial management can prevail.

BASIC SYSTEM ELEMENTS

To understand financial management, it is essential to decipher the reports provided to the manager. To comprehend these reports, it is helpful to understand certain basic system elements that are used to create the information contained in the reports.

Chart of Accounts—The Map

The chart of accounts is a map. It outlines the elements of your company in an organized manner. The chart of accounts maps out account titles with a method of numeric coding. It is designed to compile financial data in a uniform manner that the user can decode.

The groupings of accounts in the chart of accounts should match the groupings of the organization. In other words, the classification on the organization chart (as discussed in the previous chapter) should be compatible with the groupings on the chart of accounts. Thus, if there is a human resources department on your facility's organization chart, and if expenses are grouped by department in your facility, then we would expect to find a human resources grouping in the chart of accounts.

The manager who is working with financial data needs to be able to read and comprehend how the dollars are laid out and how they are gathered together, or assembled. This assembly happens through the guidance of the chart of accounts. That is why we compare it to a map.

Basic guidance for healthcare charts of accounts is set out in publications such as that of Seawell's *Chart of Accounts for Hospitals.*[2] However, generic guides are just that—generic. Every organization exhibits differences in its own chart of accounts that express the unique aspects of its structure. We examine three examples to illustrate these differences. Remember, we are spending time on the chart of accounts because your comprehension of detailed financial data may well depend on whether you can decipher your facility's own chart of accounts mapping in the information forwarded for your use.

The first format, shown in **Exhibit 2–1**, is a basic use, probably for a smaller organization. The exhibit is in two horizontal segments, "Structure" and "Example." There are three parts to the account number. The first part is one digit and indicates the financial statement element. Thus, our example shows "1," which is for "Asset." The second part is two digits and is the primary subclassification. Our example shows "10," which stands for "Current Asset" in this case. The third and final part is also two digits and is the secondary subclassification. Our example shows "11," which stands for "Petty Cash—Front Office" in this case. On a report, this account number would probably appear as 1-10-11.

The second format, shown in **Exhibit 2–2**, is full use and would be for a large organization. The exhibit is again in two horizontal segments, "Structure" and "Example," and there are now

Exhibit 2–1 Chart of Accounts, Format I

Structure		
X	XX	XX
Financial Statement Element	Primary Subclassification	Secondary Subclassification

Example		
1	10	11
Asset	Current Asset	Petty Cash— Front Office
(Financial Statement Element)	(Primary Subclassification)	(Secondary Subclassification)

Exhibit 2–2 Chart of Accounts, Format II

Structure				
XX	XX	X	XXXX	XX
Entity Designator	Fund Designator	Financial Statement Element	Primary Subclassification	Secondary Subclassification

Example				
10 Hospital A	10 General Fund	4 Revenue	3125 Lab—Microbiology	03 Payer: XYZ HMO
10 Hospital A	10 General Fund	6 Expense	3125 Lab—Microbiology	10 Clerical Salaries
(Entity Designator)	(Fund Designator)	(Financial Statement Element)	(Primary Subclassification)	(Secondary Subclassification)

two line items appearing in the Example section. This full-use example has five parts to the account number. The first part is two digits and indicates the entity designator number. Thus, we conclude that there is more than one entity within this system. Our example shows "10," which stands for "Hospital A." The second part is two digits and indicates the fund designator number. Thus, we conclude that there is more than one fund within this system. Our example shows "10," which stands for "General Fund."

The third part of Exhibit 2–2 is one digit and indicates the financial statement element. Thus, the first line of our example shows "4," which is for "Revenue," and the second line of our example shows "6," which is for "Expense." (The third part of this example is the first part of the simpler example shown in Exhibit 2–1.) The fourth part is four digits and is the primary subclassification. Our example shows 3125, which stands for "Lab—Microbiology." The number 3125 appears on both lines of this example, indicating that both the revenue and the expense belong to Lab—Microbiology. (The fourth part of this example is the second part of the simpler example shown in Exhibit 2–1. The simpler example used only two digits for this part, but this full-use example uses four digits.) The fifth and final part is two digits and is the secondary subclassification. Our example shows "03" on the first line, the revenue line, which stands for "Payer: XYZ HMO" and indicates the source of the revenue. On the second line, the expense line, our example shows "10," which stands for "Clerical Salaries." Therefore, we understand that these are the clerical salaries belonging to Lab—Microbiology in Hospital A. (The fifth part of this example is the third and final part of the simpler example shown in Exhibit 2–1.) On a report, these account numbers might appear as 10-10-4-3125-03 and 10-10-6-3125-10. Another optional use that is easier to read at a glance is 10104-3125-03 and 10106-3125-10.

Because every organization is unique and because the chart of accounts reflects that unique-ness, the third format, shown in **Exhibit 2–3**, illustrates a customized use of the chart of ac-counts. This example is adapted from a large hospital system. There are four parts to its chart of accounts number. The first part is an entity designator and designates a company within the hospital system. The fund designator two-digit part, as traditionally used (see Exhibit 2–2), is missing here. The financial statement element one-digit part, as traditionally used (see Exhibit 2–2), is also missing here. Instead, the second part of Exhibit 2–3 represents the primary classifi-cation, which is shown as an expense category ("Payroll") in the example line. The third part of Exhibit 2–3 is the secondary subclassification, representing a labor subaccount expense designa-tion ("Regular per-Visit RN"). The fourth and final part of Exhibit 2–3 is another subclassifica-tion that indicates the department within the company ("Home Health"). On a report for this organization, therefore, the account number 21-7000-2200-7151 would indicate the home care services company's payroll for regular per-visit registered nurses (RNs) in the home health de-partment. Finally, remember that time spent understanding your own facility's chart of accounts will be time well spent.

Books and Records—Capture Transactions

The books and records of the financial information system for the organization serve to capture transactions. **Figure 2–4** illustrates the relationship of the books and records to each other. As a single transaction occurs, the process begins. The individual transaction is recorded in the ap-propriate subsidiary journal. Similar such transactions are then grouped and balanced within the subsidiary journal. At periodic intervals, the groups of transactions are gathered, summa-rized, and entered in the general ledger. Within the general ledger, the transaction groups

Exhibit 2–3　Chart of Accounts, Format III

Structure			
XX	XXXX	XXXX	XXXX
Company Category	Expense	Subaccount	Department
(Entity Designator)	(Primary Classification)	(Secondary Subclassification)	(Additional Subclassification)

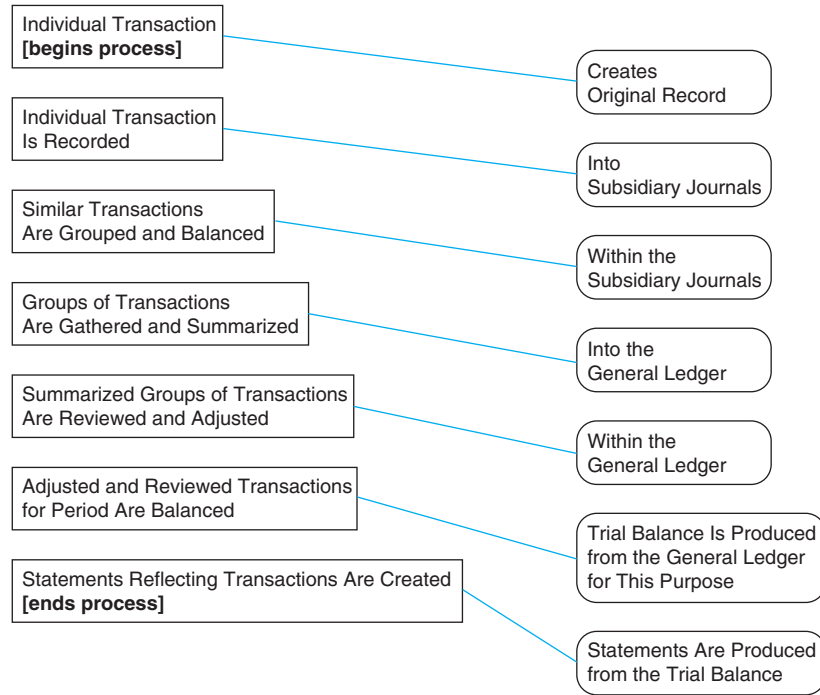| Example			
21	7000	2200	7151
Home Care Services	Payroll	Regular per-Visit RN	Home Health
(Company)	(Expense Category)	(Subaccount)	(Department)

Figure 2–4 The Progress of a Transaction.
Courtesy of Resource Group, Ltd., Dallas, Texas.

are reviewed and adjusted. After such review and adjustment, the transactions for the period within the general ledger are balanced. A document known as the trial balance is used for this purpose. The final step in the process is to create statements that reflect the transactions for the period. The trial balance is used to produce the statements.

All transactions for the period reside in the general ledger. The subsidiary journals are so named because they are "subsidiary" to the general ledger: in other words, they serve to support the general ledger. **Figure 2–5** illustrates this concept. Another way to think of the subsidiary journals is to picture them as feeding the general ledger. The important point here is to understand the source and the flow of information as it is recorded.

Reports—The Product

Reports are more fully treated in a subsequent chapter of this text (see Chapter 11). It is sufficient at this point to recognize that reports are the final product of a process that commences with an original transaction.

THE ANNUAL MANAGEMENT CYCLE

The annual management cycle affects the type and status of information that the manager is expected to use. Some operating information is "raw"—that is, unadjusted. When the same information has passed further through the system and has been verified, adjusted, and
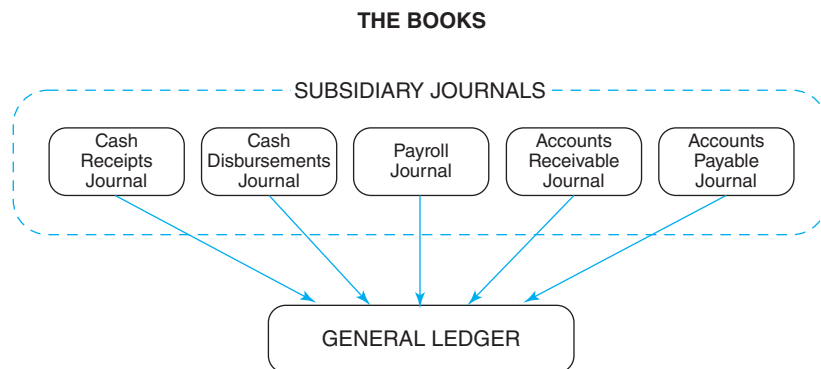
THE BOOKS

Figure 2–5 Recording Information: Relationship of Subsidiary Journals to the General Ledger.
Courtesy of Resource Group, Ltd., Dallas, Texas.

balanced, it will usually vary from the initial raw data. These differences are a part of the process just described.

Daily and Weekly Operating Reports

The daily and weekly operating reports generally contain raw data, as discussed in the preceding paragraph. The purpose of such daily and weekly reports is to provide immediate operating information to use for day-to-day management purposes.

Quarterly Reports and Statistics

The quarterly reports and statistics generally have been verified, adjusted, and balanced. They are called interim reports because they have been generated some time during the reporting period of the organization and not at the end of that period. Managers often use quarterly reports as milestones. A common milestone is the quarterly budget review.

Annual Year-End Reports

Most organizations have a 12-month reporting period known as a fiscal year. A fiscal year, therefore, covers a period from the first day of a particular month (e.g., January 1) through the last day of a month that is one year, or 12 months, in the future (e.g., December 31). If we see a heading that reads, "For the year ended June 30," we know that the fiscal year began on July 1 of the previous year. Anything less than a full 12-month year is called a "stub period" and is fully spelled out in the heading. If, therefore, a company is reporting for a three-month stub period ending on December 31, the heading on the report will read, "For the three-month period ended December 31." An alternative treatment uses a heading that reads, "For the period October 1 to December 31."

Annual year-end reports cover the full 12-month reporting period or the fiscal year. Such annual year-end reports are not primarily intended for managers' use. Their primary purpose is for reporting the operations of the organization for the period to outsiders, or third parties.

Annual year-end reports represent the closing out of the information system for a specific reporting period. The recording and reporting of operations will now begin a new cycle with a new year.

COMMUNICATING FINANCIAL INFORMATION TO OTHERS

The ability to communicate financial information effectively to others is a valuable skill. It is important to

- Create a report as your method of communication.
- Use accepted terminology.
- Use standard formats that are accepted in the accounting profession.
- Begin with an executive summary.
- Organize the body of the report in a logical flow.
- Place extensive detail into an appendix.

The rest of this book will help you learn how to create such a report. Our book will also sharpen your communication skills by helping you better understand how heathcare finance works.

INFORMATION CHECKPOINT

What is needed?	An explanation of how the information flow works in your unit.
Where is it found?	Probably with the information system staff; perhaps in the administrative offices.
How is it used?	Study the flow and relate it to the paperwork that you handle.

KEY TERMS

Accounting System
Chart of Accounts
General Ledger
Information System
Original Records
Reporting System
Subsidiary Journals
Trial Balance

DISCUSSION QUESTIONS

1. Have you ever been informed of the information flow in your unit or division?
2. If so, did you receive the information in a formal seminar or in an informal manner, one-on-one with another individual? Do you think this was the best way? Why?

3. Do you know about the chart of accounts in your organization as it pertains to information you receive?
4. If so, is it similar to one of the three formats illustrated in this chapter? If not, how is it different?
5. Do you work with daily or weekly operating reports? With quarterly reports and statistics?
6. If so, do these reports give you useful information? How do you think they could be improved?

NOTES

1. J. J. Baker, *Activity-Based Costing and Activity-Based Management for Health Care* (Gaithersburg, MD: Aspen Publishers, Inc., 1998).
2. L. V. Seawell, *Chart of Accounts for Hospitals* (Chicago: Probus Publishing Company, 1994).