

# Keeping Risk in Check

The complexities inherent in performance-based contracts call for increased board oversight

By James J. Pizzo and Debra L. Ryan

Hospitals and health systems increasingly are entering performance-based contracts as part of the trend toward population health and value-based care. These arrangements typically require organizations to accept greater financial risk for the care they provide by agreeing to deliver defined services to a specific population at a predetermined price and quality level.

The provisions contained in contracts between payers and providers are becoming more complex. Previously, the major items may have involved rate increases and duration. Today's contracts often specify performance standards that hospitals must meet to earn incremental increases, such as improved efficiencies or the achievement of quality metrics, like reductions in readmissions per 1,000 population.

While the pace of change varies from market to market, trustees should provide financial stewardship and guide their organizations through the transition. This requires boards to step up their involvement in the review and approval of new performance-based contracts.

Historically, boards have received

only high-level summaries from executive leaders outlining the implications of contract provisions. Trustees seldom review contracts in depth, except when a contract represents a new venture or involves a major modification to existing terms.

That needs to change. The complexity of performance-based con-

tracts and potential implications for finances and operations make board involvement in contract assessment more important than ever. Trustees will need to evaluate the overall level of financial and actuarial risk the system will assume, and the impact of revenues that may be lost (both in covered lives and fee-for-service encounters) if the organization can't negotiate a position with the payers. Senior leaders also should seek board counsel and input during such negotiations because of the potential difficulty and effect on both the com-

munity and the health system.

In some cases, payers are seeking significant payment reductions, or asking organizations to assume an inadvisable amount of risk. Further, as contracts become more contested, participation agreements are being terminated more frequently. Becoming a nonparticipating provider can result in a damaging loss of covered lives and revenue. Trustees must be aware of negotiating status, proposed changes to risk characteristics and acceptance of performance threshold metrics. This will enable them to ensure that executive leaders are assessing all possible variables.

## Key Criteria

Trustees should be familiar with how the executive team is setting the organization's contracting strategy and evaluating contracts. In reviewing performance-based contracts, criteria to consider include:

- **Revenue expectations.** How projections are calculated varies by the type of contract and the level of assumed risk. The board should have a general understanding of how these

Trustees must be aware of negotiating status, proposed changes to risk characteristics and acceptance of performance threshold metrics.

calculations are made and the various factors involved to know how future revenue expectations compare with historical trends.

- **Overall operational and financial effects.** Performance-based contracts increasingly require organizations to meet operational standards — including stipulations regarding care coordination — that require additional investments, such as the addition of care management protocols. Boards and leaders must weigh carefully these provisions to avoid entering into a contract with which the organization will be unable or unprepared to comply.

- **Cost of contract requirements.**



Center Voices comes from the American Hospital Association's Center for Healthcare Governance.

In addition to assessing the organization's ability to meet operational requirements, leaders should understand the associated financial and personnel costs and whether additional staff or infrastructure will be needed.

- **Required reserves and auditability.** Because contracts involve the assumption of risk on the providers' part, payers in some states are requiring organizations to have reserves in place to help offset those risks and guarantee the continued provision of care to patients. Boards and leaders should be aware of these types of stipulations, as well as their ability to provide accurate and timely financial reporting to auditors.

- **Inpatient and outpatient utilization patterns and care costs.** Depending on the type of contract, utilization trends and cost of care will affect revenues. Higher-than-expected utilization, even with contained costs,

will result in lower profits.

- **Population served.** Identifying the demographics and associated risks with the population served is essential. Even within populations, some contracts are structured so that the payment methodologies vary for different subgroups, such as fully insured patients versus the self-insured.

### Don't Rush In

In evaluating performance-based contracts, boards and executive leaders have to weigh organizational resources and capabilities against potential risks and rewards. At the same time, they must be aware of the potential consequences of losing a contract, if doing so gives competitors a market advantage.

How contracts are structured affects not only how organizations are paid, but also their short- and long-term strategic goals. For example, many payers are scrutinizing the pro-

vision of inpatient care, and focusing on whether outpatient services may be more appropriate in some cases. Such decisions will have a dramatic impact on a hospital's plans for growth or contraction of inpatient and outpatient services.

Depending on the pace of change in their markets, some hospitals may feel intense pressure to enter into performance-based contracts. Yet, the intricacies of these contracts require that they undergo thorough review involving executive and financial management, the board and operational leaders to ensure that the full implications of all contract terms have been evaluated. **T**

---

**James J. Pizzo** ([jpizzo@kaufmanhall.com](mailto:jpizzo@kaufmanhall.com)) is a managing director and **Debra L. Ryan** ([dryan@kaufmanhall.com](mailto:dryan@kaufmanhall.com))



is a vice president of Kaufman, Hall & Associates Inc. in Skokie, Ill.