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What to Expect When a Consultant Call-in Report Is Required

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A difficult operating environment has affected the financial position of many hospitals and health systems. For some organizations, this means that they face the prospect of breaching covenants in their master trust indenture (MTI) or bank loan documents, particularly covenant requirements for debt service coverage or days cash on hand. In the event of a breach, management is typically required to hire an independent consultant to identify areas for financial and operational improvement that will bring the organization back into compliance with its financial covenants. The outcome of this process is captured in a consultant's report, which describes to investors and lenders the organization's potential opportunities for improvement.

Management does not need to wait for a covenant breach to initiate a consultant call-in; by being proactive, management may be able to avoid a breach and strengthen the organization's position with investors if, for example, they wish to seek an amendment to an existing covenant. This article provides an overview of what a consultant call-in does—and does not—entail and offers some considerations for timing and implementation.

The consultant call-in

There are certain things a consultant call-in is *not*: it is not an indictment of an organization's strategy or a vote of no confidence in management. Instead, it is focused on turnaround opportunities, taking the organization's current plans and initiatives as its starting point. Most organizations are well down the path to generating financial turnaround plans, so it is important to acknowledge the hard work which the hospital has already undertaken. However, often more is needed to meet financial turnaround planning targets. Given where the organization is today, what opportunities are there for further improvement, and how long will it take to implement and realize those opportunities?

Most organizations are well down the path to generating financial turnaround plans. However, often more is needed to meet financial turnaround planning targets. Given where the organization is today, what opportunities are there for further improvement, and how long will it take to implement and realize those opportunities?

A good consultant call-in report will produce a comprehensive operational review of the organization, with quantified financial opportunities across key areas of opportunity, including revenue cycle, labor and non-labor expenses, the physician enterprise, care transitions, clinical documentation improvement, and balance sheet improvements (e.g., debt structure, real estate portfolio, and treasury operations). Opportunities will often be quantified within a low-to-high range of expectations by fiscal year end, with projections on when those opportunities will impact the income statement or balance sheet over time.

Timing matters

The timeline for realizing financial improvement is important and raises a more significant question of timing for the consultant call-in itself. The purpose of the consultant call-in is to identify opportunities that will bring the organization back into compliance with its bond or loan covenants and avoid future breaches *by the end of the next fiscal year*. The longer management delays initiating the call-in, the less time it has to implement the consultant's recommendations. Under the terms of the MTI or other loan documents, an organization may have, for example, 90 days from the end of its fiscal year reporting requirements in which a breach occurred to retain a consultant or a certain amount of time (e.g., four to six months) after publication of the audited financials to do so. The consultant then may have another six to eight weeks to prepare the report. At this point, the organization will be halfway—or farther—into its next fiscal year, with little time remaining to implement the consultant's recommendations and begin to realize the identified opportunities. This, of course, raises the prospect of another breach, which could prompt a more negative response from investors. Again, a proactive response from management when it realizes a breach is likely will buy more time to realize opportunities and strengthen investor relationships by demonstrating that management is committed to identifying all opportunities available to right the ship as soon as possible.

Management has another important decision to make at this juncture: whether it will retain the consultant to implement its recommendations or whether it will take on implementation itself. Both are valid options, but if management decides to do it themselves, the consultant likely will add additional disclaimers in its report to investors.

The report

The detailed assessment of opportunities that the consultant prepares for the management team is not the report that goes to the investors. Instead, the consultant will prepare a much shorter document that outlines the range of opportunities for financial improvement it has identified and the time it estimates it will take the organization to realize those opportunities. The report will note that realization of the opportunities the consultant has identified will depend on successful implementation of the consultant's recommendations. As noted earlier, this disclaimer will be stronger if the consultant has not been retained to lead implementation or if the management team has decided not to pursue all the consultant's recommendations.

Regardless of who is leading the implementation, investors will require periodic updates on progress toward the identified improvements. If the consultant has been retained to lead implementation, its regular progress updates for the health system also can be used for investor updates.

Additional considerations

The consultant call-in process and investor relations will inevitably be messy if a covenant breach is imminent. There is no standard industry language that defines when a consultant call-in is required or how much time the organization has to retain a consultant and produce a report for investors and banks. A deep dive into the specifics of the documents—likely with the help of bond counsel—will be required.

To the extent that management is working with investors to secure a waiver, amendment, or forbearance of a covenant, that task will be complicated by the number of parties involved and the changing profile of those parties as trades occur. Efforts to secure a waiver (i.e., an agreement by investors not to enforce a covenant for a certain period), an amendment (i.e., an actual change to the terms of a covenant), or a forbearance (i.e., an agreement by investors and other debtholders to hold off—but not relinquish—enforcement of the covenant) range from hard, to harder, to very hard. In the case of forbearance, for example, investors and banks are likely to require additional conditions, including the right to accelerate the debt at any time if their conditions are not met. In all cases, the process of negotiation and compliance will consume both financial resources and time.

Throughout the process, transparency is key. The earlier that management can get in front of their investors, banks, and rating agencies, the more goodwill they will earn and the more time they will have to improve the financial health of their organization.

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