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Accounts Receivable Evaluation in the Health Care Practice, Part 1

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The evaluation of accounts receivables (A/R) in the health care practice is an ambiguous and difficult process. On an accrual basis, a practice may appear quite successful - until further investigation reveals there is a definitive lack of cash flow to support operating expenses. Most small businesses utilize a cash methodology of accounting that reflects timely financial transactions, but they do not adequately address the collectibility of the remaining A/R accounts. Practices that accept governmental public programs, managed care contracts, and payment from litigious claims, often discover that a dollar produced may not be a dollar earned. Further ambiguity may arise as to when, depending on the type of case, the revenue generated is actually collected.

This article discusses how to evaluate the viability of A/R and assess a true value. Maximizing the potential of the A/R can mean a significant increase in profits, with little additional effort or expense. This article does not address HMO issues of capitated prepayment plans, risk pool revenues, and stop-loss adjustments.

Many publications have suggested evaluating open A/R using simple accounting formulas, such as assessing all accounts 0-30 days aged at a 90 percent value; 70 percent for 31-60 days; and 50 percent up to 90 days. This may grossly work for smaller noncontested A/R, but it is far too simplistic to be utilized in a larger health care practice with managed care contracts and litigious claims.

Collection rates may also be an area of confusion. Many practices and software programs utilize a basic formula of:

However, this simplified formula may be fraught with erroneous assumptions, leading to many poor decision-making processes. For example, if the denominator of total practice production drops dramatically in a given month, the collection percentage increases proportionately, with no dollar increase in collections. Additionally, if the total dollars produced significantly increases, the collection percentage decreases. Thus, by increasing service dollars, a practice may errantly appear to be failing when actually, it may be simply improving production at a rate faster than collections.

Evaluation should always allow for significant delays between revenue production and actual collection. Utilization reviews, improper patient information, and incorrect billing procedures are just a few of the reasons a claim payment may be delayed several weeks to even months. If the practice finances care on the basis of lien settlements and workers' compensation claims, collection may take up to several years. This is a primary reason why collection divided by production is not an effective method of tracking an accurate collection percentage. The dollars collected today may not be representative of the contemporaneous production. An accurate measurement of collection must be tracked directly from the same dates and cases from which the revenue was produced.

A second method of account tracking may be simply to divide the total collections by the total production from a specific time period. For example, if $100,000 was produced in June 2000, how much of that specific revenue was later collected? This method is more accurate than the former and may work if, as will be shown, the exact case population that produced the revenue is measured and utilized for analysis. However, this does little to account for a breakdown of specific case type collection analysis, and any factors affecting past or present collection potentials.

A true evaluation of the financial aspects of any business begins with a firm foundation on the basic understanding of accounting principles and statistics, and a thorough analysis of all accounts. This becomes more imperative as the practice grows larger. (A complete description of practice valuation is outside the scope of this article.) If this analysis is being performed to assist in establishing a selling price, A/R may be a primary point of disagreement. Evaluation of the A/R consists of determining the external factors affecting the accounts, and then directing a primary focus on the specific internal steps for ascertaining a true outstanding A/R value. The objective of this evaluation is to determine the future theoretical collection of the current A/R by measuring it against past performance. The future is never certain; however, the more factors considered that may affect future performance, the closer one will be to assessing true A/R worth.

External Account Factors

External factors of consideration include all the entities an assessor will need to review when determining a total practice evaluation. These factors may determine if the determined collection percentage is an accurate reflection of future potential.

Key Staff Members

A strong key factor to accurate account management always begins with the staff. Identify who is in charge of the accounts, as well as their education and experience. Many physicians feel their only responsibility is to see patients. However, in most practices, a direct relationship can be noted between a strong A/R collections and physician responsibility. Associates should also be made aware of all aspects on their particular patient accounts. Legal responsibility for billed charges always remains with the treating physician.

Account Management Process

The evaluator should be aware of the methodology by which the practice tracks accounts on a daily basis; the efforts utilized to collect on outstanding balances; and the control systems utilized to determine when an account is considered not collectable. In many practices, account types may each be handled differently. A determination should be made of how the clinic follows accounts, and the standard operating procedures utilized to assure collections are maximized to full potential. What are the standard time frames set for follow-up on each account type? Is the staff efficient at following the standards? Is there an individual assigned and responsible for follow-up on each account? Are the individuals assigned to collections cognizant of all the current federal and state laws that may affect the collection process for each account type, including any potentially illegal billing/collecting practices? For example, ERISA insurance claims are regulated by federal law, not by each state department of insurance. Does the staff understand the proper appeals procedures and legal assignment of benefit language necessary to secure payment? The insurance companies are not going to educate you of your rights and the necessary steps to collect your money. Finally, how does the staff interact with the payors, including claim representatives and attorneys? Are they strong in their approach, and can they determine mathematically the correct amount to be collected by each of the parties involved? Does the practice have the desire and the knowledge to maximally potentiate collections?

Many account recovery companies scavenger off the remaining monies left over from unorganized and indolent collection systems, on the basic premise that the clinic did not collect to the full potential. Each account should be managed with timely follow-ups and accurate write-off procedures.

Reports and Statistics

An analysis should also be made of how statistical reports are generated each month, and any errors within. Do the reports include pertinent data to accurately analyze the A/R? Limiting the amount of potential human error in data input and assessment is important. One suggestion may be to utilize a good practice-management program, which can do many of the things automatically that this article illustrates manually. It should be cautioned that software can only produce numbers and reports for what it is instructed to do; it does not interpret the meaning of the data derived. Human error may still be involved. A system should keep a basic balance of all accounts and (preferably) be able to itemize them into categories. Most systems have internal reports that give a strong view of the practice productivity and generated revenue.

One key area of caution recognized with many software programs involves the identification and adjustment of specific service dates paid at less than the charged amount. This generally involves reduced payments due to usual and customary audits, managed care contracts, and reasonable and necessary denials. Example: If a particular date of service billed at $100 is paid at 50 percent per contract, a remaining balance of $50 will be left on the patient's outstanding account, even though this money is truly not collectable. This error would be multiplied for each date of service until the entire uncollectable account balance is completely written off. Thus, 10 dates of service would errantly inflate the A/R by $500. Open account categories generally affected are contracted health insurance (major medical and group health) plans. Facilities with a large number of open accounts may have a grossly exaggerated total A/R and should be evaluated with scrutiny.

The Collection Environment

This area of analysis includes all factors that may affect future collection rates when compared to past performances. Factors may include:

- Legal and/or legislative changes at the federal, state, or local levels.
- Practice or physician under investigation for any reasons that may affect future collections? Remember, by purchasing a practice, you are not only acquiring assets, you are also potentially acquiring liabilities. This author recommends for any buyer to demand an asset -

based purchase, as opposed to a stock-based purchase.
- Has the physician severed relationships with a previous payor or business/personal relationship that may have an affect on future revenue?
- Has the collections staff recently changed?

These are only a few examples of the many potential hazards that may inhibit future collections performance. The analyzer must perform a due diligent search of any factors particular to your practice.

Internal Account Factors

A direct evaluation of the A/R is meant to answer two basic questions, "How much money can be potentially collected from the examined A/R, and in what time frame?" Understanding the formula for the net present value of money is outside the scope of this paper. However, considering factors of interest and investing power, a dollar collected today is worth more than two collected in a year. Thus, it is imperative to consider the time frame of collections on each account type. The following is a step-by-step process of the actual A/R analysis:

1. Determine the Total Gross Amount of A/R Outstanding

Many practices may not be aware of exactly how much is outstanding in the A/R. This is the first basic step necessary for a proper evaluation.

2. Individual Account Viability

Each practice should periodically review each account to assure they are still potentially collectable. Accounts determined to be uncollectable will remain in the A/R total balance unless properly written off. A complete review process should be performed by the collections supervisor at least one time each quarter, as a secondary means of assuring all standard procedures are being followed appropriately. Accounts with an unexpectedly long collection period should be evaluated with close scrutiny. Buyers should make sure the stated A/R is accurate and current. An overinflated A/R may affect current practice value and future cash flow.

Account viability also includes determining the realistic gross value one should expect to collect on the produced charges. This begins with an analysis of the current fee schedule and comparing it to any particular managed care, workers' compensation, and insurance fee schedules. Fee schedules for a given geographical area can be verified as usual and customary by comparing the charges with insurance remuneration explanation of benefits. However, since each insurance company may utilize its own internal or external source of fee data, it is recommended to cross-verify usual and customary charges with either a vendor data base or a credible fee-analyzer source.

3. Account Categorization

The separation of accounts may be one of the most important steps to truly understanding the current characteristics and future expected collections of A/R. Possible categories may include:

- Medicare/Medicaid
- Managed care cases by each major contract
- Workers' Compensation (per each major insurance company)
- Personal injury (per each insurance company)
- Traditional indemnity payor categories
- Cash
- Other identified categories

The individual performing the analysis should determine what categories would most accurately reflect the desired results. How finite each category should be broken down is primarily determined by the number of patients for evaluation. If the category contains only a small percentage of patients, it may not be necessary to break it into particular sections. If, however, a particular class contains a dominant category, such as Blue Cross/Blue Shield patients, one may need to separate these cases for analysis. As described above, it is also important to identify each managed care contract and insurance fee schedule. Identify each patient associated with each particular contract for determination of reimbursement expectations. Finally, determine if the past reimbursement patterns have matched that of the expected. Each facility and/or physician therein may have different managed care contracts. If this analysis is being performed for the determination of a selling price, the buyer should perform due diligence in researching each contract for transferability.

4. Case Selection and Review

This part of the process consists of determining the specific cases to review from each category, as well as the number of cases to be analyzed. In most given statistical analysis, it is not feasible to review an entire population of data and formulas to help determine the proper number of samples to utilize. The population number of useable accounts in most health care facilities is generally small enough to utilize the entire population available from each category when possible.

Selection bias is an inherent danger when evaluating a given sample from a large population of data. It is from this sample that one will statistically formulate assumptions about the entire population. Selection bias not only occurs by human error, it can also occur due to natural population differences. This is especially true when assessing health care accounts. Before analyzing the chosen sample, we must first assess if this sample is an accurate representation of the entire population. One common error that occurs is premature measurement in sample analysis. Cases from a given population of data that resolve earlier most probably do so due to a lack of barriers that may inhibit collection. They may, in all probability, not only collect earlier, but at a higher percentage. If one measures the first 100 out of 200 cases from the year 2000, he or she may make a false assumption about the collectability of the remaining accounts. Adjustments for future potentials must be recognized by the analyzer. Determining when the accounts should be completely written off is imperative. Insist on a dated A/R list that extends several years, not merely 90 days.

One should also be cautious of a second sampling error, utilizing data from a past population when the current environment has changed. Remember, the goal is to equate past results with the future earning potential of the current A/R. All factors must remain equal. The data from several years past may not be representative of the current operating procedures, case types, referral patterns, practice clientele and political/legal aspects.

The analysis of past performance should utilize data representative of the current A/R population in both external environmental considerations and similar internal account characterization. It may not always be feasible to be perfect; however, one should strive to come as close as possible, and remember to account statistically for any cases in the data set that are not included in the data analysis that may influence results. This is especially true for those accounts with higher balances, as they will affect the mean to a higher degree than smaller balances. Therefore, one must assess all the factors that may attribute to the statistical representation.

Editor's note: The conclusion of this article will appear in the next California Forum.

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