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Accounts Receivable Evaluation in the Health Care Practice, Part 2

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5. Data Extraction

Once the specific cases for analysis are identified, one must determine what information is necessary for review. It should be noted that due to current patient confidentiality regulations, a physician may need to obtain authorization to release any protected health information (PHI) to a potential buyer or third-party analyzer. For the purposes of strict A/R analysis, only nonspecific data items are necessary: case type, date(s) of treatment, total charges, total collections (with collection percentage), initial date of care, and the date of final payment/settlement. This information does not need to contain any specific patient identification and can be easily entered into a statistical analysis software program.

6. Data Analysis

This section addresses the primary issues of concern: determining the actual value of the accounts. Utilizing historical past collections data, the analyzer can predict future accounts performance. The necessary data have already been collected, and at this point, the analyzer can determine the following information:

Date(s) of care	Total charges	Collection amount	Percentage of collection	Time of final payment or settlement	Total length of care (days)

Label: Case Type (category)

1. total data elements (case numbers) for each category
2. total collection amount and percentage per case
3. total average collection amount per category
4. average collection/settlement times per category

This data should then be compared with all open accounts to estimate current A/R value, as well as future collections and cash flow potentials. It is always important for current practice owners and potential buyers to evaluate how much cash will be necessary for operations, capital investments, or estimated current liabilities. Many potentially successful businesses have failed because of a simple mismanagement of cash influx. The above formula should be able to estimate the expected cash inflows and timeframes, all future factors being equal. Cash patients, general group insurance, and contracted care should pay expectedly sooner than accounts financed with third-party settlement options.

Plotting the data on a graph may be beneficial to determine visually how the data clusters around the mean. This may also serve to identify any existing outliers. Determining how to interpret the meaning of any outlier is specific to each analyzer. One should always remember that the more extreme the outlier, the greater it will affect the mean and skew the data. Sampling small numbers that include extreme outliers will not be representative of the true data set, and false assumptions will be made without a thorough investigation. Compensational methodologies may include leaving the outlier out of the analysis or using the median of the data set instead of the mean to assess the central point of the data. Entering the data in a good basic statistical software program may provide valuable instantaneous information that is difficult and time-consuming to calculate by hand.

A full understanding of statistical terms and analysis is outside the scope of this paper. I recommend utilizing an individual who properly understands statistics to assist in the data analysis.

Utilizing A/R for Financing

Utilization of a health care business A/R to secure financing may be a difficult process. Most financers generally work on the basis of a graduated 30/60/90-day system of account viability. Health care is one of the few industries in which a majority of the payment is often due well after the service is performed. This is especially true if the practitioner agrees to finance some accounts on the contingency of a third-party settlement. Most businesses outside of health care work on the premise that payment is due either prior to or within close proximity to the service: generally NET 30. The importance of substantiating the viability of the A/R before trying to secure a loan is imperative for all parties involved. It develops realistic expectations and a true valuation of worth. It also demonstrates that the individuals requesting financing fully understand all aspects of the entire collection process.

Accounts receivable are generally utilized to secure financing via two primary methodologies. The first is called pledging. This is simply using the A/R as collateral to secure a loan from a lending institution. An existing owner can use this method if a short-term source of cash is necessary to expand the business, invest in assets, or override a temporary cash-flow deficiency. A purchaser can present this to a lending institution as proof of business solvency and as collateral to back a loan. Traditional loan sources such as banks generally will not lend against accounts.

The second method by which A/R is used to secure financing is called factoring. This is simply selling off the account balances to a financer who specializes in this industry. Accounts are sold at some factor, or discount percentage, of the balance value on the books. Do not expect the purchase to be based on your valuation of the A/R. Financing organizations that purchase A/R generally charge a commission and a discount percentage on the accounts to assure their purchase is profitable. A common example of factoring is credit card sales. The retailer pays a percentage fee to a financer, usually anywhere from 1-4 percent, for the financer to pay the account and take on the risk of debt collection.

Factoring is one of the most popular forms of financing used in business today. For the seller, it provides an immediate source of necessary cash flow for operations and business expansion. The buyer benefits from a calculated profit, with a return higher than the investment. Many factoring organizations may not invest in health care accounts due to their volatility and ambiguous nature. This holds even more true for A/R heavy in litigious claims, as these accounts often take longer to settle and factoring is meant primarily as a short-term financing option.

The basic information necessary in the determination of the factoring formula is dependent on four primary factors:

1. the total A/R amount and categories;
2. the average collection rate per account type;
3. the average collection time per account type; and
4. an agreed-on discount rate between the financer and seller.

The first three factors are the same necessary pieces in determining the correct collection percentage, as described above. The fourth factor is again outside the scope of this paper. Always review several bids and companies, as factoring contracts may be very dissimilar. An attorney familiar with this form of business is strongly recommended to review all contracts. Financing companies willing to provide factoring capital for healthcare accounts are rare. Those that do will generally require a large A/R balance (> $500,000) with a heavy discount rate before they will assume a risk. This is especially true for accounts heavy in litigious claims that may take years to settle and are unpredictable.

Conclusion

In an economic sense, remember that business is about one thing: increasing profitability. This can generally be done in two ways. The first is by increasing revenue production at a rate higher than the increased expenses necessary to produce the additional revenue. While this adds to the bottom line of the company, it also adds all the burdens of growth, such as adding more staff, a larger accounts management, more responses to more insurance companies for denials, more time, and so forth. The second method is by reducing the cost of operational resources utilized to produce the revenue by focusing on improved efficiencies. By decreasing the expenses and increasing the collection percentage of the accounts already being produced, profitability can go up substantially, with little to no additional effort and just slightly more diligent time. Efficiency is necessary before a business can be profitable. In my opinion, a practice should first review the areas of unnecessary revenue loss, operational flow processes, and expenses before attempting to grow. Once a business has improved all procedures to maximally efficiency and effectiveness, growth in size can be achieved. In fact, many good practice managers teach that if a clinic becomes maximally efficient, growth naturally follows.

The collection process for health care accounts receivables is a primary area of concern for every practice. By thoroughly reviewing every account, an analyzer can demonstrate the true collection rate and help accurately predict the future rate of return.

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