

CODE BLUE

Resuscitating Bad Debt

Author: Cliff Boyd

"The healthcare industry's bad debt situation is in crisis mode right now," laments Dr. Ron Anderson, long-time CEO of the prominent Parkland Health & Hospital System in Dallas. "Legislative health policies want us to care for everyone who comes through our door, but the government's support is often only enough to achieve mediocrity, which counters our conviction to achieve excellence."



Healthcare facilities nationwide are enduring near epidemic levels of outstanding debt. Stephens Inc. analyst, Joe Chumbler, estimated the amount of delinquent healthcare debt available to be serviced or sold at a colossal \$25 billion, while others feel this number could be in excess of \$150 billion. In either case, this astronomical number is rising annually, exacerbated by a growing population of uninsured, a shift in healthcare costs to consumers, and governments ratcheting down on healthcare contributions.

There is no time to delay. If the healthcare industry does not act with urgency – and if they fail to explore aggressive, out-of-the-box approaches – this situation will quickly move from a quandary to a calamity. Repercussions can be as extreme as attrition, acquisition or even bankruptcy.

In fact, according to Standard & Poor's Rating Services, the industry outlook for the remainder of 2006 and into 2007 remains bleak. The company's recent ratings outlook shows that, of the 14 rated companies in the for-profit corporate hospitals sector, 67 percent have negative rating outlooks, versus 17 percent in 2003.

Rippling Effects of Consumer-driven Healthcare

Imagine if the entire population of California were uninsured, or if every American over the age of 65 were forced to pay for full-priced healthcare out-of-pocket. With Medicaid eligibility changes acting as just one stone in the pond, the waves of change are growing and census reports now place the number of uninsured Americans at greater than 45 million. Suddenly, the unthinkable have become tangible examples of the crisis currently facing the healthcare industry. Uninsured "self-pay" accounts are the number one contributors to healthcare bad debt, which is the debt that hospitals deem uncollectible. At the end of the day, hospitals are forced to pass along unpaid healthcare costs to consumers, employers and taxpayers in the form of higher insurance premiums. In 2005, employer health insurance premiums for all types of health plans increased by 9.2 percent - nearly three times the rate of inflation – and it marked the fifth consecutive year of increases over 9 percent. These higher rates force many companies to drop their coverage altogether, further feeding into the vicious cycle of bad debt as these companies' employees join the ranks of the uninsured.

Even the insured are feeling the pinch. Companies unable to cover record-high healthcare insurance rates – especially the fast-growing small business sector – are shifting the brunt of the healthcare burden to employees. The critical issue is that monthly

premiums, co-payments and deductibles have spiked so high that they are unrealistic for most consumers' pocketbooks.

"What used to be a \$100 deductible is now a \$1,000 deductible and many just can't feasibly write a check for that amount," said Jim Perry, Parkland's Revenue Cycle Vice President. "We're a true public hospital and our role is to care for the under-served; therefore, we don't turn away patients who can't pay, but we've also got to wear our business hat."

Public and private hospitals alike worry that the advent of government-backed high-deductible health plans and health savings accounts will only perpetuate their bad debt woes by interjecting more patient payment responsibility.

Changing Roles of Public Healthcare Facilities and ERs

In recent years, emergency rooms have replaced general practitioners as the first stop for many un- or under-insured. Without the luxury of consistent and affordable care enjoyed by their insured counterparts, these patients clog emergency rooms with ailments ranging from simple earaches to grave complications from common illnesses that have gone untreated. Additionally, a 1986 federal law (EMTALA) states that emergency rooms must treat all patients, regardless of their means – binding the hands of emergency centers when it comes to treating patients.

Statistics show that nearly 60 percent of uninsured public hospital stays originated in the emergency department, with less than half of those initial emergency room visits classified as emergent or urgent. Charity care in public facilities is significantly higher on average as well.

Public hospitals and emergency rooms that intake a large number of indigent and immigrant patients are particularly susceptible to the grave and cyclical effects of unpaid care. Bill Snekvik, Director of Patient Financial Services for Platte Valley Medical Center in Brighton, Colorado, says his rural facility grapples with this issue – trying to qualify unwilling patients for charity care or other federally subsidized programs.

"We're a farming community, so we see an influx of migrant workers in the summertime," notes Snekvik. "We bend over backwards with a nearly unparalleled staff of financial counselors and four FTEs to help patients qualify for assistance, but if people are unwilling to provide the information needed to qualify for charity care, then we can't help them."

Revving Up the Revenue Cycle Upfront

While obvious issues such as emergency rooms congested with uninsured patients can cause long-term problems for a healthcare facility's revenue cycle, sometimes the smallest and most common mistakes can bring the cycle to a screeching halt. Simple and avoidable errors such as entering incorrect names, addresses and codes into the system can wreak instant havoc.

In fact, several large, national healthcare consulting firms have stated that arming registration desks with more skilled and savvy employees will further ensure the revenue cycle gets off to a more profitable start.

It is clear that revenue cycles are continuously failing upfront because facilities are employing high school-level clerks for \$6 to \$8 an hour to run sophisticated computer systems, yet they're not trained properly to capture the necessary information for accurate billing. Most healthcare facilities

would benefit from building up a professional registration staff instead of enlarging their billing departments.

Perry agrees, noting that, "If you obtain good demographic information early in the lifecycle, employ highly trained people to process it and pre-register the patient, and have the tools in place to validate it, you can influence the outcome of an account." He adds that, "If we've done our work properly and have good information, once an account gets to bill status it should get paid."

Repercussions of Medical Bad Debt

Regardless of the root causes, it is impossible for healthcare institutions to ignore the grave and sweeping impacts of bad debt – particularly as it affects their bottom line. Average bad debt expense climbed to 3.58 percent of revenue in the third quarter of 2004. Many institutions are even seeing bad debt account for upwards of 10 percent of revenues. This equates to hundreds of millions of dollars in rightfully owed revenue that is unavailable for critical investments, such as new technology, new or expanded facilities, patient programs, IT expenditures, personnel and payroll.

"It's critical for hospitals to have the capital they need to invest in IT, new construction, replacement facilities and progressive programs," said Dr. Anderson. "Even though we're a public hospital with subsidies, our margins are extremely narrow and it affects our ability to fund everything we need to continually deliver exceptional patient care."

Managing bad debt is both time-consuming and financially taxing on already strapped healthcare institutions.

CFOs, controllers and revenue cycle managers are beleaguered by the task of establishing and maintaining acceptable operating margins and dealing with thinning cash flow. Decreases in patient revenues, managed care rate reductions, rising healthcare salaries, and hiccups in revenue cycle management are also inhibiting bottom-line growth.

What Can Be Done?

First, the collections/liquidation cycle must be shortened to bring much-needed cash closer to the time of the expense. Second, the cost of managing the collections process must be reduced. The current collection process is too lengthy and ineffective, predominantly due to the means by which collection agencies are retained, as well as the failure of hospital management to recognize bad accounts as valuable assets.

Traditionally, hospitals select collection agencies that offer the lowest collection fees (charges to collect). When collection agencies receive low fees, they typically only expend high levels of effort and expense for a short period of time to collect on the accounts, and then that effort drops off significantly. The problem is additionally exacerbated as the agencies receive new accounts each week. They would rather focus their efforts on the "low hanging fruit," rather than to expend resources on aging accounts that are more difficult to collect, causing the debt load to multiply many times over.

These circumstances leave hospitals with growing non-earning assets representing accounts not being pursued for collection. More sophisticated hospitals recall these accounts from the primary collection agency and place them with a secondary and, sometimes, a third agency. This process results in higher collection rates, but also represents a higher internal cost for hospitals,

since managing the account flow and performance of multiple agencies requires additional staff. Even the most efficient collection process is costly to manage and the cash flow recovery can take several years.

Managing bad debt as a valuable asset and collecting rightfully owed revenue has become a necessity rather than an option. Whereas public relations stigma and fears of losing patient control have historically pre-empted healthcare organizations from taking a strong approach to debt collections, the time is right for a new approach. One burgeoning option that is paying dividends for a number of healthcare facilities is selling and/or leasing the servicing rights of aging charged-off accounts receivables for immediate cash. Debt selling is worth serious consideration for all healthcare entities, both public and private.

Debt selling is not a new concept. In fact, companies seeking to recoup on credit card, consumer loan, auto loan and commercial debt have used debt selling for years. However, it has only emerged recently as a popular option for recovering bad healthcare

debt, and despite its successful track-record, debt selling is still often considered a “progressive” approach.

Instant cash in hand is the number one motive steering the healthcare world to debt selling. With the government curbing reimbursements and hospitals in serious need of cash, they’re forced to loosen the protective reins on their receivables and start looking at out-of-the-box ways to manage this valuable asset. The inability of healthcare facilities to obtain working capital on self-pay debt is another reason to explore selling bad debt. With an inordinate number of consumers responsible for a higher percentage of their healthcare expenditures, this concern is growing greater daily.

Benefits of Debt Selling or Licensing

- Immediate cash from dormant assets
- Reduction in overhead associated with management of collections activities
- Net increase in cash flow
- Selling bad debt early in the process can minimize bad debt reserves
- New cash flow permits funding of unbudgeted projects

Benefits of Debt Selling or Licensing

- Immediate cash from dormant assets
- Reduction in overhead associated with management of collections activities
- Net increase in cash flow
- Selling bad debt early in the process can minimize bad debt reserves
- New cash flow permits funding of unbudgeted projects

“Generally, in our industry, people are a tad behind the curve and afraid to shift the paradigm,” observes Perry. “However, we’ve got to keep pace with the changing times. One impetus I’ve seen toward A/R sales is the increased public pressure to properly handle the uninsured. Organizations are more reticent to file liens, scoot ‘grannies’ out of their houses and take other acute measures, and that will clearly affect their ability to collect on accounts.”

“We’re always going to be mindful of patient relations and of maintaining our role as a community servant,” continues Perry. “However, by the time these accounts have reached the point where they’re considered part of our bad debt pool, we rest assured that we’ve exhausted all options and not left anything on the table. They’ve gone through the collection process, bad debt agencies and early-out programs, and this is our final chance to recover some of what we’re due.” A boom in the number of reputable and financially stable debt buyers who understand the healthcare industry has also contributed to the industry’s growth. Organizations that sold their debt years ago with poor or mixed results should take a second look at the approach given its evolution in recent years.

Converting Charge-offs to Hard Cash

Ask any CFO the value of their aging accounts receivables, their debt expense looking forward over a five-year period, or how much they are collecting on their debt based on its age, and more often than not, they can rattle off the exact figures. Yet many still stand idly by as millions in bad debt is charged-off and deemed uncollectible after as few as nine months.

It is the dust-gathering warehoused accounts – today, at least – that are prime considerations for selling. For instance,

Parkland Health & Hospital System recently extended an RFP with a succinct goal of collecting a percentage of these otherwise-exhausted bad debt receivables.

“It’s a huge opportunity to accelerate your cash flow,” points out Perry. “If you sell a couple million dollars worth of bad debt, that’s money you can use for working capital and re-investment into your facilities. You’ll get more on the dollar, while spending less and using fewer resources. What’s most important to us is that we’ll receive our money up front rather than it being amortized over the lifetime of the account.”

Today, many healthcare providers are showing an increased interest in debt selling for the instantaneous and predictable results. Many organizations are reaching a point where they don’t want to spend any more resources or FTE time collecting debt, so it makes sense for them to sell it and receive the benefit of immediate cash flow. In their search for new means to effectively manage their debt as a business asset, this approach stands out for its simplicity and the guarantee of free cash in their hands within a few days or weeks.

“An immediate influx of cash is a positive thing – I don’t care how you slice and dice it,” says Snekvik. “We were able to direct our newfound capital into our common fund and it’s being applied to both immediate and long-term needs.”

Testing the Waters Before Taking the Plunge

As with any new and innovative approach, healthcare providers are treading lightly by sampling the debt selling process before diving in headfirst. A recommended approach is to select one or two blocks of debt to start, and then expand the program to all debt of a certain age.

For example, Snekvik encouraged the CFO and other decision-makers at Platte Valley Medical Center to try selling a portion of its bad debt after reading articles discussing the pros and cons. The decision was made to sell a block of inactive debt that ranged from one to three years old to Colorado-based Healthcare Funding Solutions (HFS).

“It was definitely a test to determine what effects, if any, it would have on the business office,” said Snekvik. “The results were overall positive. I told my staff that the volume of incoming patient calls would be high for a few months, but they really only lasted a couple weeks, and I can say that I haven’t received any calls whatsoever in the last six months.”

Snekvik is seriously evaluating a second go-around at selling his center’s outstanding

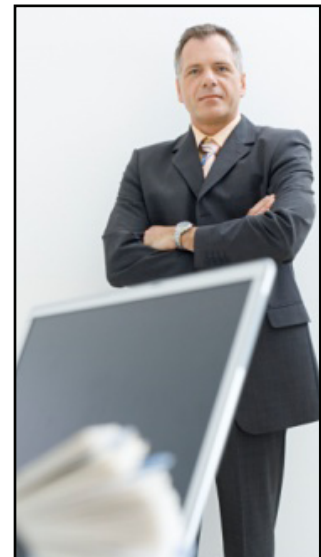
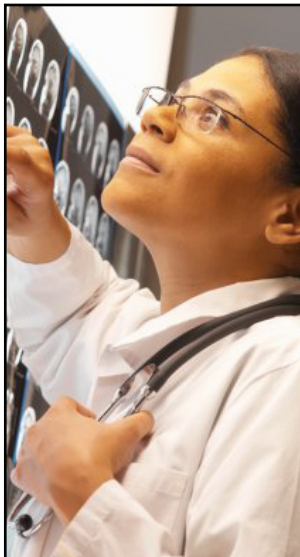
account receivables. He has requested a second download of accounts and is reviewing the dollar amounts with the Platte Valley Medical Center CFO before making the final decision.

Parkland is similarly approaching bad debt selling by initially dipping its toes in the water. Parkland has decided to break up its RFP into two bids – one comprised of newer accounts that should yield well and one comprised of warehoused accounts. It will trial the process for six months to a year, and if desired success is achieved, Parkland will extend its partnership with the debt buyer indefinitely.

Dissecting the Debt-selling Process

The instant rewards of selling debt cannot be ignored. However, before delving into the process, it is helpful to understand the steps involved to ensure that you are asking the right questions and finding the best partner for your needs. Standard components of the debt-selling process include:

Proper Timing – What accounts can be sold? Currently, hospitals are looking to sell their “warehoused” accounts. These are accounts that have made their way through an internal process, an early-out program, and one or more collection agencies,



and are now receiving very little, if any, attention. However, healthcare providers are increasingly looking at the benefits of selling fresher batches of accounts because they are recognizing that the sale of accounts can represent an ongoing component of their recovery program.

Valuing the Debt – There are many variables that determine the value of a portfolio. One of the primary variables is which processes have been performed on the portfolio (e.g. how may third-parties have tried to collect the debt?). The more third parties involved, the lower the value. If a potential seller would like to gauge the worth of their receivables in advance, they should be able to do so by providing a debt buyer with the same information they send to their collections agencies. A key consideration is the amount of information provided to potential bidders. The more information the bidders can access, the better the bids.

Bidding Process - Typically, bad debt is priced through an RFP or bidding process whereby the pool of potential debt buyers is narrowed down through research and each is asked to submit a proposal for consideration. Most buyers should be able to submit a bid with only a few days' notice and access to basic account information. Once bids are provided, the seller should understand the basis of all bids. Factors such as the resale of accounts, ability to file lawsuits, ability to report to credit bureaus, and other contract provisions all have a meaningful impact on price. The highest price might not be the best deal for the seller.

Contracts and Payment – Selling bad debt can be a highly expedited process. Once a contract is determined and signed, facilities should be paid the full sum in a matter of days.

Obtaining Patient Data – The primary means for securely sharing basic patient data with debt-buying partners is either to grant them read-only access to the facility's system or to invite them on site to gather it. Other options include working through a secure FTP site or providing it on a CD-ROM. It is critical that both parties assess all potential security risks when sharing patient data and the process is compliant with HIPAA standards for patient privacy. An outside consultant can be engaged if any uncertainties exist.

Determining Accounts to Sell – To maximize value, "scrub" all accounts prior to selling them and omit those that cannot be collected upon.

Handling Disputes – The debt-buying partner typically handles disputes. However, in many instances, the partner will need to either acquire more information from the healthcare facility or work in tandem with them to resolve the issue.

Recourse Debt Buying vs. Recourse Factoring – With recourse debt buying, healthcare facilities are only obligated to buy back accounts that were unintentionally included in the sale and do not meet mandated qualifications (e.g. instances where the patient is bankrupt, deceased, incarcerated, covered under charity care, or if the account is fraudulent or paid prior to the



sale date). If such instances occur, the facility will be required to buy back the accounts for the same price for which they were sold and/or to exchange the accounts for other valid ones. Recourse debt buying should not be confused with recourse factoring whereby healthcare facilities are required to re-purchase accounts that the factoring company is unable to collect.

Forward Flow – An ongoing, scheduled process where the partner agrees to buy a specific category of debt at a pre-determined price. This situation ensures a constant and predictable source of revenue for the health care provider.

In Summary

Healthcare organizations faced with revenue cycle and cash flow issues must think and act differently about their business processes or face dire consequences. Parkland CEO, Dr. Anderson, contends that selling accounts receivables is an approach worthy of thorough consideration for all indebted medical facilities, a belief that has prompted Parkland to move forward with the process. However, he warns that it should be treated as a long-term partnership, as opposed to a one-off business tactic. “We’re in this for the long run and want a partner who is as well. We’re seeking a partner who will work through our backlog, and if they’re successful, then it will spawn continued success for them via additional business from us and word-of-mouth marketing.”

For Perry, there is no question that selling receivables will someday replace what collections agencies are doing today. For now, Parkland is taking the first step to maximize its revenue in its ongoing quest to treat patients with the best care possible.

“We have an obligation to Dallas County to try new avenues like this to continue to fund our facility,” says Perry. “For us to continue to

not maximize our revenue and operations is irresponsible to the taxpayers.”

Once your organization has similarly decided to gain immediate cash reward by selling its bad debt, the first step is to seek out a reputable and savvy debt buyer as a partner. Initially engaging a debt buyer elicits several questions and considerations that, if addressed at the outset of your relationship, can help optimize your experience. These are addressed in detail in Addendum A at the conclusion of this paper.

Furthermore, if you are seriously considering selling your healthcare organization’s aged account receivables, it is important to first do your homework to determine which company and approach is best suited for your given situation. Industry associations such as the Healthcare Financial Management Association (HFMA) and the Debt Buyers Association can be good starting-points. You might also want to seek the opinions and insights of trade groups, analyst firms and colleagues. Or, head straight to the source by checking directly with reputable debt buyers such as Healthcare Funding Solutions.

Healthcare Funding Solutions:

www.healthcarefunding.com

HFMA: www.hfma.org

Debt Buyers Association:

www.debtbuyers.com

About the Author

Cliff Boyd is a long-standing veteran of both the healthcare and financial industries, and currently serves as an advisor to Healthcare Funding Solutions. Boyd owned and operated an accounts receivable business for more than 25 years and has spent more than 20 years sitting on the boards for several hospitals, including serving as the chairman of the Board of Managers for the Dallas Parkland Health & Hospital System. His experience also includes many years with the U.S. Government as a certified internal auditor; terms as mayor, city councilman, and chairman of the Chamber of Commerce in Duncanville, Texas; past chairman of the board of the First State Bank of Texas; and member of the board of directors of the Dallas Association of Credit Management.

Cliff Boyd
402 W Wheatland Rd
Suite 170
Duncanville, TX 75116
Phone: 214-869-0741
Email: cboyd1@1stmetro.net

ADDENDUM A

Considerations for Selecting a Debt Buyer

- **Verify the debt buyer's experience.**

Ask detailed questions to understand the company's history and level of industry experience.

- **Confirm that the debt buyer services accounts too.** Some debt buyers only purchase the debt and utilize independent collection agencies to service it. As a best practice, opt for a company that will both buy and service the paper.

- **Determine the best time to introduce the debt buyer into your revenue cycle.** Most facilities engage debt buyers when their accounts have reached "charged-off" status, having gone through an internal collections process, an early-out process, and typically through one or more collections agencies.

- **Determine the value and details of your debt.** How many accounts do you have? How old are they? Which ones should you sell to a debt buyer vs. those to be collected by an agency?

- **Be willing to open your books and do not hesitate to provide comprehensive information.** The more information you are able to provide to a debt buyer, the more completely they can evaluate your portfolio to provide the best pricing structure.

- **Ensure that your debt buyer adheres to mandates and regulations for patient privacy.** HIPAA and FDCPA, for example, are federal regulations in place to protect the privacy and rights of your patients. It is imperative that your debt buyer adheres to these regulations to ensure that your patients' rights are preserved. Have the debt buyer sign a business associate agreement prior to sharing files with them.

- **Investigate secure communications options provided by your debt buyer.**

Options such as secure, read-only access to your billing system ensure added protection for you and your patients as well as saving time for your staff. Additionally, investigate the debt buyer's systems and security procedures.

- **Evaluate how much cash flow you require and in what timeframe.** The collection process for a self-pay account can take days, months, even years. Working with a debt buyer can significantly accelerate cash flow and help you meet your needs sooner rather than later.

- **Determine whether you can repurchase accounts.** Positive relationships with your patients are key to your business. For your peace of mind, ask a potential debt buyer whether you can repurchase accounts at any time and for any reason; if there is a cap on quantity; if there is a price mark-up; and if you can exchange for other valid accounts versus paying for them in cash.

- **Ensure the debt buyer operates nationwide or in the regions that you require.** In addition to national regulations, many states have specific laws regulating debt collection. Make sure your debt buyer understands and operates within these parameters.



- **Review and understand the fine print in the contract.** Your reputation with your patients is paramount, so closely examine the contract to understand the collection methods allowable by the debt buyer. For instance, are they at liberty to place liens, sue or send accounts to a credit-reporting agency?

- **Determine whether the debt buyer can tailor the contract terms to suit your specific needs.** Debt selling should be a personalized experience because not all healthcare organizations operate similarly. Seek out partners who are flexible on contract terms and provisions and willing to work within your needs.

- **Investigate the current and future financial stability outlook for your selected debt buyer.** As with all business partnerships, you want a debt buyer that has the financial wherewithal to fund the proposed transaction quickly and sustain the proposed offer over the long term.

- **Establish your primary point of contact.** Having one point of contact with your debt buyer can ensure continuity and a deep understanding of your account. Determine up front whether you will have one primary point of contact or whether the responsibility will be divided within your organization.

- **Evaluate your internal administrative needs.** Working with a debt buyer should reduce some administrative work on your end. You will want to ensure this is the case by carefully examining the internal staffing necessary to support this newly established relationship.

- **Confirm that the debt buyer is audited by a credible accounting firm, and that they can provide proof.** A debt buyer that undergoes an annual SAS 70 audit by a large accounting firm will likely be better trained to manage your asset and ensure your patients' confidentiality. Ask your debt buyer for documentation of their most recent audit.

- **Determine whether you can lease accounts vs. selling them.** Some public companies are not at liberty to sell their assets, including debt. Check with your attorneys or advisors to determine if leasing is a better option for you.

- **Investigate whether the debt buyer offers new tools or options for working with patients.** Some debt buyers offer additional services such as mortgage refinancing that can help patients with payments.