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National Association of Community Health Centers, Inc.®

FINANCIAL MANAGEMENT SERIES

Evaluating Accounts Receivable

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This publication was supported by Cooperative Agreement Number U30CS00209 from the Health Resources Services Administration, Bureau of Primary Health Care (HRSA/BPHC). Its contents are solely the responsibility of the authors and do not represent the official views of HRSA/BPHC.

Regular monitoring and reporting of key financial indicators are important for ensuring the financial health of an organization. By reviewing performance in critical areas, management can identify symptoms of underlying issues that need to be addressed. This is exemplified by review of accounts receivable, since this amount can directly impact upon an organization's revenues, and more specifically, the liquidity of its assets.

This Information Bulletin provides a summary of why accounts receivable represents such a critical aspect of financial reporting, and how Health Centers can improve their analyses of this high exposure balance sheet item.

WHY EVALUATE ACCOUNTS RECEIVABLE

Accounts receivable represent the amount of money that is owed to an organization for services provided at a specific point in time. The reasons why an organization evaluates the amount of money in their accounts receivable includes:

- The greater the amount of the receivable, the less money the organization has received and has available to spend, therefore reducing cash flow.
- If there's a problem in the timely collection of accounts receivable, it generally leads to larger accounts payable balances (angry vendors) because the organization must delay payment of its own bills.
- Interest costs may increase because a short-term loan may be required to get the organization through this "cash crunch." In addition, an accounts receivable balance that is overstated on the balance sheet will hide losses or inflate profits that an organization has incurred.

COMPONENTS OF PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable is derived from the Health Center's gross charge per the billing system net of contractual adjustments, pro-

vision for bad debts, and cash received. The following is a detailed analysis of the components of patient accounts receivable:

Gross Patients Accounts Receivable

The gross patients accounts receivable represents the uncollected patient services balance at any point in time as indicated on the Health Center's aged accounts receivable subsidiary ledger.

Allowance for Contractual Adjustment

This contractual adjustment (contra-receivable account) represents the difference between the amount the HEALTH CENTER charges and the amount they have agreed to accept for payment. This is recorded on the receivable, only if the allowance for contractual adjustment for the revenue is recorded when the cash is collected. While the preferred method is recording the receivable net of contractual allowances at the date of service, some Health Centers record the contractual allowance when cash is received, since they are unsure what the contractual allowance will be. If the HEALTH CENTER uses this method, at any point in time, a certain amount of the accounts receivable balance should be estimated as a contractual allowance account.

Allowance for Doubtful Accounts

This is a provision that estimates the portion of gross accounts receivable that will be uncollected at any point in time. Uncollected receivables occur because of denial of claims by insurance carriers, nonpayment by self-pay patients, or various other circumstances. This estimate should be based on history or another reasonable estimate.

STEPS TO EVALUATE ACCOUNTS RECEIVABLE

Generally, accounts receivable is one of the larger amounts included on an organization's balance sheet. Therefore, it is imperative to have the proper tools in place to monitor receivables and measure their impact on cash flow. The best analytical tool is to calculate how many days it takes an organization to collect its receivables. This is referred to as **"Days in Accounts Receivable."**

1. **Determine Days in Accounts Receivable.**

   The Days in Accounts Receivable calculation reveals the number of days it takes from the patient's date of service to the time the organization receives payment. This calculation is determined by using the following formula:

   Days in accounts receivable = <u>the accounts receivable amount</u> net revenue divided 365 days

2. **Compare to Prior Month, Year, Industry Averages.**

   Days in accounts receivable should be compared to the prior month and the prior year to identify possible trends that need to be investigated.

   An organization should also compare their days in accounts receivable data to industry averages.

3. **Calculate by Payor Class.**

   Calculate days in accounts receivable by payor class (e.g. Medicaid, Medicare, etc.) This may provide you with a hint as to where the real receivable problem may lie. Health Centers usually have between 30-60 days on average in a healthy accounts receivable. Over 60 days suggests a problem.

4. **Maintain an Accounts Receivable Subsidiary Ledger**.

   The Accounts Receivable Subsidiary Ledger is an aged detail listing of the outstanding accounts receivable balances, which should be reconciled to the general ledger on a monthly basis. An organization should maintain an Accounts Receivable Subsidiary Ledger to monitor who comprises the accounts receivable balances, thus enabling collections. When it is established that all methods of collection have been exhausted,

the account should be written off. This will reduce the unneeded paper trail of old uncollectible accounts. Organizations should establish procedures for ensuring that accounts receivables that are outstanding for a specific period of days, *i.e.,* 90 days, are followed-up on.

5. **Calculate Accounts Receivable for Other Receivables**.

   The days in accounts receivable should also be calculated for other receivables that a Health Center incurs. For example, a Health Center may have received a contract that requires invoices to be submitted on a monthly or quarterly basis. In this instance, it would be helpful for the Health Center to calculate the days in accounts receivable since a high number may indicate a problem. It is possible that the Health Center is not submitting the vouchers on a timely basis or, perhaps, they are being denied due to errors occurring during preparation. This will result in a reduction in the Health Center's cash flow and, as discussed above, may impact the ability of the Health Center to pay its current accounts payable.

WHAT THE ANALYSIS REVEALS

By calculating the Days in Accounts Receivable, the following issues can be brought to the forefront:

Significant increase in days in accounts receivable may signify problems with the billing procedures or software.
For example, the accounting department may be recording the revenue and receivable based on the information it is receiving from the billing department. However, if the organization is not getting paid, the accounts receivable will continue to grow, thus increasing the days in accounts receivable and reducing cash flow.

An increase in days in accounts receivable may also expose a front desk registration problem.
If proper procedures are not in place to ensure the correct information is recorded for insurance purposes, this could result in denied or pending claims. This will put the onus on the organization to investigate these claims and re-bill them as soon as possible. However, it will have already impacted cash flow because the organization was not paid on a timely basis if at all.

By calculating the days in accounts receivable by individual payor sources, the slow and delinquent payers will be easily identified.
With this information an organization can determine its course of action with that particular payor source.

ACCOUNTS RECEIVABLE FOR PATIENT SERVICES REVENUE

The patient service revenue stream directly impacts the viability of a Health Center. All Health Centers must maximize patient services revenue by ensuring that the billing, collection and front desk procedures are in place and are being followed properly.

Types of Patient Services Revenue

The traditional sources of patient services revenue are:

- **Medicaid –** A federally aided, state operated and administered program which provides medical benefits for certain low income persons in need of health and medical care. Only certain types of indigent are covered.
- **Medicare –** Nationwide health insurance program for people aged 65 and over, for persons eligible for social security disability payments for over two years, and for certain workers and their dependents who need kidney transplantation or dialysis.
- **Private Insurance –** Also referred to as Other Third Party
- **Managed Care –** Managed care agreements with Medicaid, Medicare and Commercial HMOs. These plans, managed by a "gatekeeper", were set up in

response to increasing healthcare costs and may reimburse either on a fee-for-service basis or through a capitation arrangement.

- **Self-Pay –** Patients who do not have insurance coverage. Health Centers may utilize a sliding fee adjustment. This is an adjustment to the amount normally charged to the patient. The amount of the sliding fee adjustment, which is based on income and family size, is defined by the Health Center. However, for federally funded Health Centers, any individual earning in excess of 200% of the Federal poverty guidelines is ineligible for the sliding fee adjustment. Conversely, patients at 100% and below should be charged the minimum fee.

Components of Patient Services Revenue

Net patient service revenue is derived from the Health Center's gross charge. It consists of the gross charge per the billing system, less bad debt and adjustments. The following is a detailed analysis of the components of patient revenue.

- **Gross Charge –** Represents the gross amount charged to the patients prior to any adjustments or allowances. The gross charge should be based on the cost of the visit as determined by the CPT code. The Health Center should review the cost-based charge structure annually to ensure that it accurately reflects the Health Center's costs.

- **Contractual Adjustment –** Represents the difference between the Health Center's gross charge and the amount the Health Center will receive from the payor. For example, the Health Center's Medicaid rate may be lower than its cost-based gross charge. In this case, the contractual allowance would be the difference between the gross charge and the Health Center's Medicaid rate. The contractual adjustment is recorded as a contra revenue account (offset or debit against revenue). As previously noted under Components of Accounts Receivable, some Health Centers prefer to record the contractual allowance at the time cash is received.

- **Sliding Fee Discount Adjustment –** Represents the discount the Health Center provides to its self-pay patients who earn below 200% of the Federal poverty guidelines. This discount is based on income and family size and is also recorded as a contra revenue account (offset or debit against revenue). Each center has the authority to define their sliding fee schedule in accordance with the board approved business plan.

- **Bad Debt Adjustment –** Represents amounts the Health Center deems to be uncollectible. This may be due to denials of claims, non-payment by self-pay patients or a variety of other circumstances.

  1. Bad debt should only be recorded for self-pay payors.
  2. All revenues and visits associated with denied claims from third party payors (e.g., Medicaid and Medicare) should be transferred to self-pay and an attempt made to collect this amount from the self-pay patient.
  3. If applicable, a sliding fee discount should be recorded against the transferred amounts. This will increase the sliding fee discount as a percent of the Federal grant, which is one of the grant reporting indicators. In addition, some states reimburse Health Centers based on the amount of self-pay patients that are treated. If these self-pay visits are understated due to not transferring denied claims, then a Health Center will not get its true share of its additional reimbursement.

HELPFUL HINTS FROM AN AUDITOR

At the end of each fiscal year, the auditors occupy the premises of the Health Center for a couple of weeks. It is the auditor's job to verify that the accounts receivable balances at year-end are collectible. In the healthcare industry, because so many patients are involved, it is impractical for an auditor to confirm each accounts receivable balance. Therefore, the auditor must rely on alternative procedures. The following are the common practices and analyses that the auditor will apply:

- Usually the auditor's fieldwork will commence a month or two after the fiscal year-end. The auditor will verify the accounts receivable balances by assessing the subsequent cash that is received pertaining to the accounts receivable balance. If the accounts receivable balance has been subsequently collected, the auditor will be satisfied and testing will cease. **This is an excellent exercise for the organization to do on its own on a quarterly basis.**

- In certain cases, the accounts receivable balances will not have been subsequently collected. This may be the result of denied or pending claims. In this case, the auditor will require a Billing Report to see the status of the rebilling process and why the claims were denied or pending. If the auditor determines that these claims were denied due to simple procedural issues and the rebilling is being accepted by the particular payer source, this will generally satisfy the testing requirements.

- It is also possible that certain sources are slow payers. The organization can prove this by showing trends including late payment.

- An auditor will attempt to reconcile the accrual-based accounting records to cash collected during the year to ensure the general ledger and billing system are recording the same information. An auditor will start with the beginning accounts receivable balance, add the revenue recognized during the year on an accrual basis, and subtract the actual cash received during the year. This should equal the ending accounts receivable balance. ***This is also an excellent exercise for the organization to perform on its own.***

- Finally, the auditor will calculate the Days in Accounts Receivable and compare them to the prior year and industry standards.

By properly monitoring and evaluating the accounts receivable balances, an organization will:

- ***Increase revenues,***
- ***Increase cash flows, and***
- ***Probably reduce audit fees!***

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