

# Sample State Critical Access Hospitals

## Financial Improvement Project Initial Financial Assessment Report Sample State

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**WIPFLI**<sup>LLP</sup>  
CPAs and Consultants  
HEALTH CARE PRACTICE

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# Project Overview

In 2015, the Sample State Department of Health (the “State Agency”) awarded Wipfli LLP (“Wipfli”) a one-year project to provide financial improvement services for the critical access hospitals (CAHs) within the state. Our work to support Sample State CAHs encompassed the following:

## Initial Financial Analysis

We conducted an initial financial analysis of all Sample State CAHs, using Flex Monitoring Team data, and other relevant data sources. While evaluating the financial indicators and operational metrics, we identified trends in Sample State CAH financial performance over time.

This Initial Financial Analysis Report includes:

- A written report documenting key findings, including key financial indicators.
- Recommendations on which Sample State CAHs were most “at risk” for financial distress.

# Project Overview

Following the submission of this Initial Financial Assessment Report, Wipfli will work with interested CAHs in Sample State on a variety of revenue cycle improvement projects designed to improve financial performance. We expect our work to encompass documentation and coding reviews, charge description master reviews, pricing reviews, and service line financial and strategic modeling services consistent with the Flex grant funding requirements and as approved by the State Agency.

# Initial Financial Assessment Report

## Objective

The objective of the Initial Financial Assessment Report was to report the current financial strength of Sample State CAHs compared to their peers at the state and local level and identify a subset of “at risk” hospitals.

In the future, as distressed hospitals request services, Wipfli will:

- Identify opportunities for improvement.
- Recommend opportunities to increase revenue, decrease expenses, or otherwise improve the overall financial stability.
- Assist in developing work plans to address key findings.
- Monitor the progress each distressed hospital has achieved to improve its financial strength.

# Initial Financial Assessment Report

## Scope and Approach

- For the Initial Financial Assessment Report, Wipfli was asked to use financial data collected by the Flex Monitoring Team (most recent data through 2014). We inquired if the Sample State Hospital Association or other state agency collects financial data on behalf of Sample State CAHs that we could add to our analysis; however, we were informed that no publically available data could be provided to assist in our work. We did, however, extract data from Definitive Health, a resource used by Wipfli to review financial, clinical, and other publically available information obtained from public sources (i.e., Medicare cost report filings, Medicare claim filings, and the Centers for Medicare & Medicaid Services' quality reporting sources such as Hospital Compare).
- Our objective was to focus on financial trends and most recently reported financial information as we worked to identify distressed hospitals. We did not want to simply repeat findings as presented in the above-referenced reports.

# Initial Financial Assessment Report

## Scope and Approach (Continued)

- A number of data elements in the Flex reports were either not reported by CAHs as part of their Medicare cost report filing process, or they were reported with values that did not seem reasonable according to the Flex Program team working on this project. Therefore, our analysis and related findings are limited to the quality of financial reporting included in the Medicare cost report filings by CAH. If additional audited financial reports had been available for these CAHs, we believe the data would likely be more reliable and comparative.
- In addition, CAHs that are a part of a larger health system may reflect more negative financial outcomes on their Medicare cost reports as a result of health system overhead that may be allocated on the cost reports. This may also alter the conclusion regarding hospitals that are “at risk” of financial distress.

# Initial Financial Assessment Report

## Scope and Approach (Continued)

- Because of these data issues, the analysis and discussion will need to be verified with other quantitative and qualitative information, as well as refreshed to capture more current financial data before final conclusions are reached on the classification of high-risk facilities.
- Finally, we noted that Definitive Health reported data from Medicare cost reports in a slightly different manner for certain data elements. For example, Definitive Health's information includes nursery days in the reporting of patient days, and the Flex data does not. Flex data also calculates the average age of plant, using a larger component of capital expense (which includes depreciation, leases, interest, and insurance) from Worksheet A of the Medicare cost report. Definitive Health's calculation of average age of plant only includes depreciation expense in the calculation. The result of this difference is that Flex data is reporting a lower average age of plant than Definitive Health's reported data. For some CAHs, this difference is significant.

# Initial Financial Assessment Report

## Scope and Approach (Continued)

The following XX CAHs were included in the Initial Financial Assessment Report on Sample State CAHs as provided to us by the state of Sample State. We noted that a few hospitals were in the process of transitioning ownership or changing names during our review.

# Initial Financial Assessment Report

## Distressed Hospital Criteria (Flex Monitoring Team)

The Flex Monitoring Team developed a model to predict CAH financial distress. The model included the following financial performance variables to determine risk of financial distress:

- Profitability (and the two-year change in operating margin)
- Reinvestment (retained earnings/total assets) (equity financing ratio)
- Hospital size (net patient service revenue)
- Competition (distance to the nearest 100+ bed hospital) and the percent of market share if less than 25 percent
- Economic status (percent of unemployment in the market area)
- Market size (population in the market area)

# Initial Financial Assessment Report

## Distressed Hospital Criteria (Flex Monitoring Team) (Continued)

Key “signals” of financial distress include:

- Equity decline by more than 25 percent
- Negative equity (fund balance)
- Unprofitability - Negative cash flow margin
- Unprofitability - Negative operating margin
- Closure

Our Initial Financial Assessment Report considered these indicators based on available data with a focus on:

- Negative fund balance (or near negative)
- Negative operating margin for three years
- Negative total margin for three years

# Initial Financial Assessment Report

## Criteria Used for Distressed Classification

To identify the distressed hospitals recommended for further assistance, we reviewed the detailed information by hospital. Next, we summarized the key variables determined to be our initial criteria for selecting distressed hospitals based on the available data:

- Was the most recently reported equity financing ratio negative (or less than 10 percent for emerging risk)?
- Did the hospital report a negative operating margin the past three years for which data was available?
- Did the hospital report a negative total margin the past three years for which data was available?

Based on this criteria, we identified the hospitals that are potentially “distressed,” and compared this list to the hospitals deemed to be at high or mid-high financial risk by the Flex Monitoring Team.

# Initial Financial Assessment Report

## Summary Analysis and Findings

Based on our initial financial assessment, we noted a range of financial strength indicators associated with Sample State CAHs:

- Size matters—most of the hospitals classified as high risk or mid-high risk by the Flex Program were small with revenue less than \$7.5 million.
- No hospitals with revenue more than \$20 million were classified as high risk or mid-high risk in 2014 as reflected below:

Summary of Financial Risk by CAH Size (2014 Values)					
Size	High Risk	Mid-High Risk	Mid-Low Risk	Low Risk	Totals
Less than \$7.5 million	6	3	1	2	12
Between \$7.5 million and \$20 million	1	2	3	7	13
More than \$20 million	0	0	1	3	4
Totals	7	5	5	12	29

# Initial Financial Assessment Report

## Summary Analysis and Findings (Continued)

The median operating margin ratios for Sample State CAHs declined slightly from 2010 through 2014 as reflected in the chart below. However, it should be noted, the 2014 data is incomplete (10 hospitals were missing this information from the dataset). Therefore, we included 2013 data on the chart below. Unfortunately, the trend is similar, reflecting an overall decline in median operating margin from 2010 through 2013.

Sample State CAH Operating Margin Trend			
	2010	2013	2014
Operating margin - High	30.8%	29.5%	16.5%
Operating margin - Low	-17.0%	-34.6%	-35.6%
Operating margin - Median	-0.6%	-1.4%	-1.6%

# Initial Financial Assessment Report

## Summary Analysis and Findings (Continued)

The median total margin ratio for Sample State CAHs also declined from 2010 through 2013 as reflected in the chart below. While we reflected the 2014 results, the data is once again incomplete making the comparison questionable.

Sample State CAH Total Margin Trend			
	2010	2013	2014
Total margin - High	16.0%	29.5%	16.5%
Total margin - Low	-16.9%	-34.6%	-35.6%
Total margin - Median	0.7%	-1.4%	0.2%

# Initial Financial Assessment Report

## Summary Analysis and Findings (Continued)

When comparing Sample State CAHs to other CAHs throughout the United States, we noted the following (based on available reported FLEX data):

- Median cash flow margin of Sample State CAHs was **below** the median cash flow margin of CAHs nationwide from 2010 through 2013.
- Median operating margin of Sample State CAHs was **below** the national median operating margin of CAHs from 2010 through 2013.
- Median total margin of Sample State CAHs was **below** the national median total margin of CAHs from 2010 through 2013
- Median average daily census of Sample State CAHs was **above** the national median average daily census from 2010 through 2013

The following page reflects actual median values for these indicators.

# Initial Financial Assessment Report

Sample State CAH Median Values and U.S. Median Values				
<b>Total Margin</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	0.72	-0.36	-0.56	-0.22
U.S. Median CAH	1.95	2.32	2.58	2.51
<b>Cash Flow Margin</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	4.73	4.67	5.52	6.09
U.S. Median CAH	6.17	6.41	7.04	6.72
<b>Equity Financing</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	57.33	55.23	53.28	59.98
U.S. Median CAH	60.31	60.00	60.70	60.32
<b>Swing Bed ADC</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	1.44	1.14	1.16	1.38
U.S. Median CAH	1.54	1.54	1.50	1.52
<b>Acute Care ADC</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	6.76	6.06	5.56	5.82
U.S. Median CAH	3.91	3.76	3.38	3.22
<b>Census per day (Swing + Acute)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sample State Median CAH	8.20	7.20	6.72	7.20
U.S. Median CAH	5.45	5.30	4.88	4.74

# Initial Financial Assessment Report (excerpt only)

Sample State Critical Access Hospital Risk of Financial Distress Summary					
	2010	2011	2012	2013	2014
Hospital 1	Low	Low	Mid-Low	Low	Low
Hospital 2	Mid-High	Mid-Low	Mid-Low	Mid-Low	Mid-Low
Hospital 3	Mid-High	Low	Mid-Low	Low	Low
Hospital 4	N/A	Low	Low	Low	Low
Hospital 5	Low	Low	Low	Low	Low
Hospital 6	N/A	Mid-Low	Mid-Low	N/A	Low
Hospital 7	Mid-Low	Mid-High	Mid-High	Mid-High	High
Hospital 8	Low	Low	Low	Mid-Low	Low
Hospital 9	Low	Low	Low	Mid-Low	Low
Hospital 10	N/A	Mid-High	Low	Mid-Low	Mid-Low
Hospital 11	Mid-Low	Mid-Low	Mid-Low	Mid-Low	Mid-High
Hospital 12	Low	Mid-low	Mid-low	Mid-low	Mid-low
Hospital 13	High	N/A	Mid-High	High	Mid-High
Hospital 14	Low	Low	Mid-Low	High	Low
Hospital 15	Low	Low	Mid-Low	Low	Low
Hospital 16	Low	Mid-Low	Mid-Low	N/A	Mid-High
Hospital 17	Low	Mid-Low	Mid-Low	Mid-High	High
Hospital 18	Mid-Low	Mid-High	Mid-Low	High	Mid-High
Hospital 19	N/A	Low	Low	Low	Low
Hospital 20	Mid-High	Mid-Low	High	Mid-Low	Mid-High

<sup>1</sup>Based on Flex Monitoring Team reporting.

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success

It is important to understand the drivers of revenue and expenses in CAHs as a foundation to discuss common challenges and to create possible solutions to improve financial performance.

### Revenue Drivers:

- Market size and market share
- Units of service provided
- Mix of services
- Payor mix
- Reimbursement per unit by payor

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Expense Drivers:

- Labor (hours and rates)
- Nonlabor:
  - Supplies (cost and quantity)
  - Services (contracted cost and quantity)
- Capital investment:
  - Facilities lifecycle
  - Usage of space and equipment
  - Cost inputs

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Common Challenges for CAHs Related to Revenue Drivers:

- Migration of services to larger facilities in the area (may be a perception that bigger is better; however, care is becoming more integrated).
- Service delivery model is not providing “quality care” (may be a perception).
- Mix of services dominated by Medicaid or other low paying payors (or self pay).
- Commercial payors using market power to reduce reimbursement or limit services.
- Ineffective revenue cycle processes not capturing reimbursement.

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Common Challenges for CAHs Related to Expense Drivers:

- Significant standby staffing in key service areas (emergency department, nursing units, or operating room).
- Limited negotiating power for supply contracts as a stand alone CAH.
- Low service volumes negatively impacting per-unit cost of service.
- Low service volumes negatively impacting per-unit cost of equipment and facilities.

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Potential Strategies to Address Revenue Challenges:

**Market and Service Assessment.** Take a good look at who your facility is serving and what percent of the market your facility is capturing:

- Be a market leader in the primary service area for services your facility excels in (primary care, chronic care management, etc.).
- Collaborate with larger facilities in the area on certain care cycles. Is there a “win win” to be created to better serve patients in your market region?
- Understand the market potential for these services based on actual “buyers” in the market.
- Develop a financial model to understand the impact if a market shift occurs for these services.
- If services are not well funded (i.e., Medicaid), are there other reimbursement sources to help fund?

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Potential Strategies to Address Revenue Challenges:

- A collaborative model of providers joining forces for insurance contracting, quality initiatives, and other sharing has been proven successful in other markets (ACO or other).
- Revenue cycle management processes to capture available reimbursement:
  - Front end
  - Mid cycle
  - Back end
- A strong compliance program cannot be overlooked to manage revenue (eliminating paybacks, fines, etc.).

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Potential Strategies to Address Expense Challenges:

- Rethink staffing plans for key labor-intensive areas. (Services not directly linked to patient care should be carefully evaluated.)
- Understand your cost per unit in key areas (emergency department, operating room, nursing units).
- Adopt innovating scheduling techniques for nonurgent services.
- Assess your staff by skill level. Could a different mix of staff better manage staffing cost in total while maintaining safety and quality?
- Determine if contracting could save money over creating the service internally (dietary, laundry, etc.).

# Initial Financial Assessment Report

## Understanding Key Drivers of Financial Success (Continued)

### Potential Strategies to Address Expense Challenges:

- Collaborative ventures have been successful at creating joint purchasing programs, which as proven very successful in lowering per-unit costs for supplies, services, and capital-type items.
- Assess your total facility's cost and utilization. Could underused assets be repurposed?

# Initial Financial Assessment Report

## Next Steps

We suggest the following next steps regarding this report:

- Review and discuss the Initial Financial Assessment Report
- Confirm selection of hospitals to receive individual revenue cycle or other support
- Focus financial improvement project work for selected hospitals as requested by the CAHs and as approved by the State Agency.

## Sample Financial Information by Hospital (excerpts only from various hospitals)

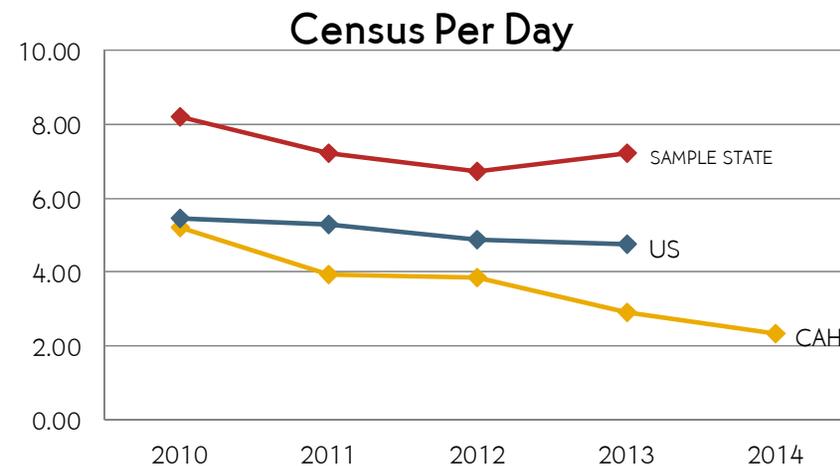
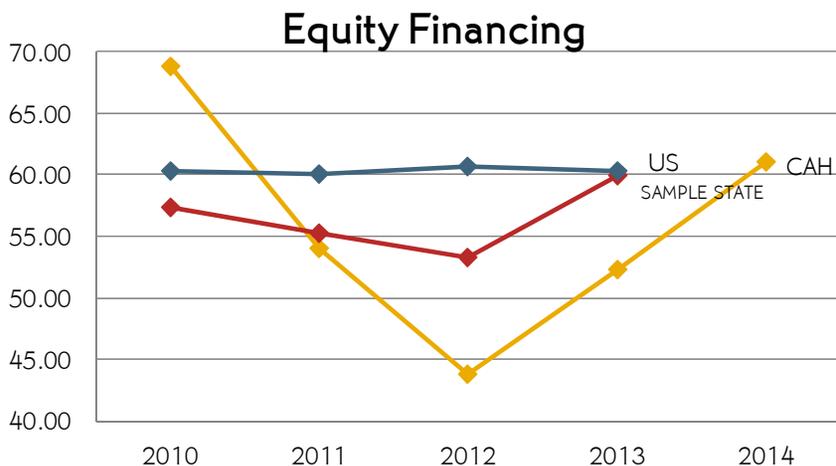
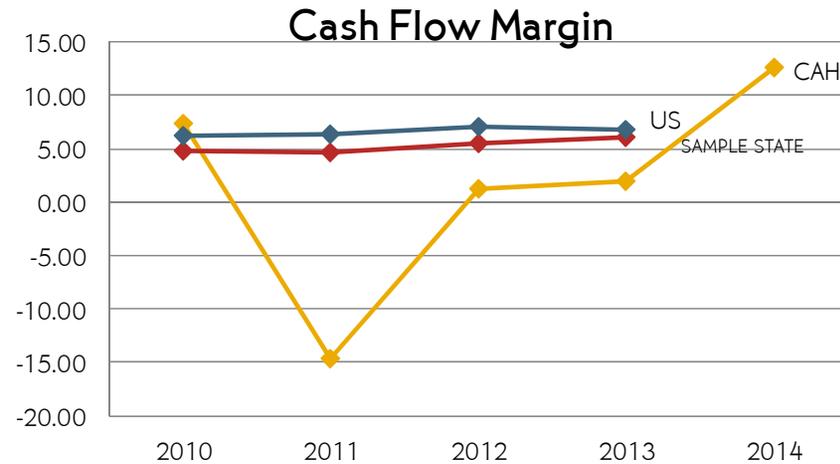
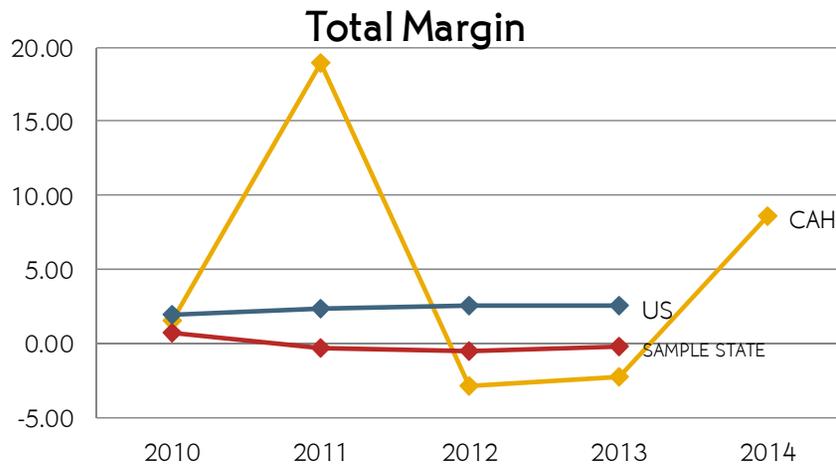
# Sample Hospital Report

Sample Hospital											
Utilization						Financial Activity					
		2012	2013	2014	Per day	Trend		2012	2013	2014	Trend
Inpatient	Beds	25	25	25			Net patient service revenue	7,424,688	7,425,989	7,255,182	↓
	Discharges	380	278	245	0.7	↓	Net operating income (loss)	(1,399,601)	(1,556,319)	(1,592,077)	↓
	Days	1,407	1,063	853	2.3	↓	Total income (loss)	(250,615)	(202,394)	834,840	↑
	Length of stay	3.7	3.8	3.5		↓	Total change in equity	(250,616)	(201,953)	834,839	↑
	Inpatient surgeries (average per week day)				-		Other change in net assets	(1)	1	(1)	↓
	Births				-		Average age of facility			17.62	↑
	Case Mix Index	0.80	0.81	0.83		↑					
							Benchmarks				
							2012	2013	2014	Trend	
Outpatient	Emergency department visits			4,422	12.1		Operating margin	-18.9%	-21.0%	-21.9%	↓
	Outpatient visits			4,483	12.3		Total margin	-2.9%	-2.3%	8.6%	↑
							Equity financing ratio	44.0%	52.0%	61.0%	↑
Quality						Affiliations					
		2014	2015	National %		Trend	Affiliation 1				
	All cause readmission rate	16.4%	14.9%	15.2%		↓	Affiliation 2				
	Overall patient satisfaction measure		69.0%	71%		↑					

Sample Hospital reflected a decrease in inpatient volumes from 2013 to 2014 and averaged 2.3 inpatients per day in 2014. Net patient service revenue decreased as well from 2013 to 2014. Sample Hospital reported a negative operating margin for all three years presented and a negative total margin in 2012 and 2013. Sample Hospital, with approximately \$7.3 million in revenue, reported an improvement in its equity financing ratio in 2014 due to nonoperating activities. The overall patient satisfaction rate was slightly lower than the national average, and the all-cause readmission rate was higher than the national average in 2014 but lower in 2015.

# Sample Hospital Report

## Sample Hospital



◆ Sample Hospital

◆ Sample State Median CAH

◆ U.S. Median CAH

# Sample Hospital Report

## Sample Hospital

Indicator	2011	2012	2013	2014	Benchmark	Sample State Indicators			
						25th	50th	75th	90th
Total Margin	18.99	-2.92	-2.30	8.62	>3	(5.96)	0.17	7.53	12.37
Cash Flow Margin	-14.64	1.22	2.00	12.65	>5	(0.36)	5.75	13.69	19.11
Return on Equity	100.00	-13.24	-11.94	33.05	>2	(2.37)	2.68	22.08	31.07
Operating Margin	-21.10	-2.92	-2.31	8.62	>4.5	(6.39)	(1.63)	7.53	12.37
Current Ratio	2.52	1.98	1.58	1.31	>2.3	0.51	1.28	3.57	5.48
Days Cash on Hand	19.83	28.12	12.48	6.68	>60	1.71	10.80	34.69	88.31
Net Days Revenue in Accounts Receivable	46.44	49.16	37.09	38.19	<53	35.46	54.26	64.76	90.88
Equity Financing	54.00	43.76	52.26	60.99	>60	55.11	67.93	83.33	90.40
Debt Service Coverage	53.81	2.14	5.48	22.57	>3	2.82	7.41	22.57	44.06
Long-Term Debt to Capitalization	27.12	35.36	15.73	14.65	<25	4.14	9.91	28.41	37.08
Medicare Outpatient Cost to Charge	0.61	0.65	0.78	0.75	<.55	0.38	0.45	0.54	0.58
Average Age of Plant	9.51	*	*	15.37	<10	7.60	12.08	15.96	18.41
FTEs per Adjusted Occupied Bed	5.55	5.40	5.23	5.53		3.85	4.73	8.07	8.79
Average Salary per FTE	42,458	42,734	43,122	44,458		40,340	44,609	49,075	57,614
Average Daily Census Swing-SNF Beds	0.15	0.30	0.24	0.11		0.96	1.37	2.23	3.55
Average Daily Census Acute Beds	3.79	3.55	2.67	2.23		2.80	5.35	6.57	7.81

Sample Hospital's operating performance is trending more favorable in 2014 than in previous years and is above the Sample State median values. Average age of plant is high compared to the Sample State median. The Flex Program classified the most current risk of financial distress as mid-high, likely due in part to negative financial performance in 2013 and previous years.

# Sample Hospital Report

## Sample Hospital 2013 Market Characteristics

Variable	Sample Hospital	Peer Group
Percent Elderly	17.3	18.4
Percent Unemployed	14.8	7.2
Per Capital Income (dollars)	15,514	20,673
Percent in Poverty	25.5	11.7
Population in Market	9,782	17,914
Population per Square Mile	14.6	32.6
Average Distance to Hospital (miles)	6.8	12.2

## 2013 Medicare Admissions

	Beneficiary Residence ZIP	Percent of Hospital Admissions	Share of ZIP	Market Leader	Leader Share of ZIP
	Zip code	54.1	30.5	Competitor 1	30.5
	Zip code	21	12.9	Competitor 2	29.5
	Zip code	8.3	28.8	Sample Hospital	28.8
	Zip code	5.5	8.8	Competitor 3	26.3
	Zip code	3.3	1.3	Competitor 4	34.3
# of Medicare Admissions in 2013	181				
% comprised of the 5 ZIPS	92.3				

## Peer Group Classification

Operated Rural Health Clinic?	No
Owned by a Government Entity?	No
Net Patient Revenue below	7.5 million
Provided Long-Term Care?	No
Number of CAHs in peer group	35

# Sample Hospital Report

## Sample Hospital - Risks/Opportunities:

- Revenue and inpatient volumes are declining.
- Small facility with total patient service revenue less than \$8 million.
- The Flex Program reported the most recent risk rating as mid-high due to a number of years of negative earnings.
- Patient satisfaction rate similar to the national median, and the all-cause readmission rate slightly favorable compared to the national average.
- Market region reported a high percentage of poverty.

# Contact Information

Should you have any questions regarding this report, please contact:



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