

FEATURE STORY

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a critical cause

10 steps to improve CAH financial performance

Critical access hospitals need to learn how to operate as businesses if they want to realize their fullest potential for financial success.

Being designated as a critical access hospital presents an important payment opportunity for a small, rural hospital. But many CAHs are not taking full advantage of this opportunity.

Since Congress passed the Balanced Budget Act of 1997, the nation has seen an explosion of CAHs. As of June 2006, there were 1,284 CAHs in the United States, compared with 884 in March 2004. This dramatic growth is largely attributed to the more favorable payment CAHs receive under a cost-based payment system than these hospitals did previously under the prospective payment system. Unfortunately, some CAHs have struggled to successfully complete the transition to the cost-based system, and as a result, the payments they have received have fallen short of what they might have been.

To various degrees, CAHs face a number of challenges that can affect their payment levels in different ways:

- > Low occupancy rates
- > High operating expenses
- > High Medicare utilization
- > High accounts receivable and slow collection rates
- > Outdated facilities and equipment
- > Prices well below those of their competitors

CAHs that are struggling with these issues must roll up their sleeves and do some work if they want to be financially sound. To thrive, they must operate their organizations as a business. They should consider the following 10 steps to improve their financial margins.

AT A GLANCE

The 10 steps:

1. Develop a strategic planning process.
2. Develop a bed-management strategy.
3. Design a revenue cycle management program.
4. Enhance Medicare payment.
5. Avoid the Medicare cash flow trap.
6. Develop effective pricing strategies.
7. Improve performance of clinics.
8. Manage labor and nonlabor resources.
9. Evaluate capital expenditures and needs.
10. Evaluate new products and services.

1

Develop a Strategic Planning Process

The critical elements on which a CAH's systematic strategic planning process should focus are community needs and competition, service mix, medical staff, revenues and costs, and recruiting and retention. To prepare

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for such a process, the CAH should assemble a strategic planning team to review pertinent data, including key financial and Medicare cost report data, data related to hospital operations and planning, and relevant financial and utilization data for physician clinic operations. Team members may include key players in the organization such as the CEO, CFO, COO, marketing director, medical director, and board chair.

The strategic planning team then should perform evaluations of medical staff composition and the physician recruiting plan; product-line profitability, service mix, and payer mix; and the impact of the primary care network. They also should conduct a market-share assessment and prepare community demographic studies.

To identify effective strategies, the strategic planning team should analyze what strategies have succeeded in the past and what changes, if any, will take the organization into the future. As part of this process, the team should critically assess the CAH's existing status, its ultimate goals, and what tactics to use to reach those goals.

To facilitate the planning process, the team should report preliminary findings from the analysis and interviews to the hospital leadership group and participate in formal planning discussions with the leadership group. One goal of these discussions should be to assess strategic options.

Participants in the strategic planning process should discuss the following issues:

- > What are the growth rates of the hospital's primary and secondary service areas?
- > What percentage of the service areas is the hospital capturing?
- > Where is the hospital's business headed?
- > What opportunities exist to increase hospital market share?
- > What should the hospital's performance be in the next five to 10 years?
- > What are the critical factors to make the hospital successful?
- > What specific goals and objectives for the hospital will be measured?

During the strategic planning process, it is important to evaluate financial implications and alternatives. Goals may be either revised or reprioritized based on financial considerations.

Initially, the team should prepare a summary of findings and document identified strategic initiatives and goals that will constitute the CAH's strategic plan. Next, the team should perform a reality check by modeling its options. This involves evaluating and quantifying each data component that provides the basis for the plan with respect to key elements of focus (e.g., community needs and competition, service mix, market share, medical staff, revenues and costs, and recruiting and retention).

Once the strategic planning goals are determined initially, the CAH should routinely revisit and modify the goals as necessary. The strategic plan thus becomes a dynamic action planning and monitoring tool.

2

Develop a Bed-Management Strategy

To achieve optimal financial performance, CAHs need to utilize acute care beds effectively. There are many ways in which CAHs can increase their acute care occupancy, while continuing to deliver high-quality care to patients. Strategies include recruiting new physicians, building replacement facilities, and implementing aggressive marketing plans.

The CAH should first evaluate historical trends and objectively determine whether the patients in its community need greater coverage and services. If so, the next step is to determine how to provide the patients with the services to which they are entitled.

Swing-bed programs are an approach that can boost a CAH's occupancy. Some CAHs limit admissions to their swing-bed programs or the average length of stay of patients who qualify for swing-bed coverage and, as a result, lose valuable payment. It is important to understand that CAHs are paid for swing beds at 101 percent of cost,

which is the same rate they are paid for acute care beds and considerably more than the rate paid for swing-beds in PPS hospitals. Regardless of whether or not the hospital is a CAH, patients *must* meet both the acute discharge and swing-bed admission criteria for the hospital to receive the 101 percent reimbursement. However, swing-bed programs are not subject to post-acute care transfer rules for CAHs.

By employing marketing strategies to increase the number of patients occupying beds either as acute care patients or swing-bed patients, a CAH can reduce its average cost per day, resulting in greater margins from self-pay patients and commercial payers. If a CAH successfully increases its Medicare acute and swing-bed days, the Medicare program will actually pay for a greater portion of the CAH's operating costs. An important caveat is that if a CAH decides to pursue this strategy, it will be necessary to educate physicians and clinical staff on the related Medicare and third-party coverage rules.

In addition to addressing bed occupancy issues, CAHs should also evaluate the performance of their home health agencies; hospices; excluded

units, such as psychiatric and rehab units; and long-term care facilities. These services receive Medicare payment under the PPS. CAHs have financial incentives to manage these programs as effectively and efficiently as possible because the Medicare program allows them to keep the difference between the PPS payments and the costs of providing the patient services. Yet sometimes these services are not on a CAH's radar screen. Benchmarking these services to industry standards is an important CAH monitoring tactic.

3 Design a Revenue Cycle Management Program

An effective revenue cycle management program starts with reviewing and negotiating contracts with third-party payers to ensure adequate payment rates. Information system requirements include patient registration and admitting systems that produce clean claims, and health information management systems that facilitate effective management of patient documentation and accurate final code assignments.

An effective program also requires a patient financial accounting system that:

- > Improves cash flow by developing and following effective policies and procedures
- > Prepares and submits clean and timely claims
- > Provides a basis for a denials management program
- > Facilitates collection efforts to reduce bad debt
- > Accommodates internal and external coding and billing audits

4 Enhance Medicare Payment

Many CAHs have a Medicare utilization rate as high as 70 percent for inpatient acute services and between 40 percent and 50 percent for outpatient services. Such levels of Medicare utilization underscore the importance to a CAH's financial viability of having an effective Medicare payment program. Measures that such a program could undertake to improve and defend Medicare payment include:

- > Reviewing cost allocation statistics (e.g., square footage)
- > Requesting cost finding changes if warranted

SURVEY HIGHLIGHTS CAH NEEDS

To evaluate the top needs of critical access hospitals, the Iowa Hospital Association conducted a survey of its 82 CAH members in the first quarter of 2006. About 70 of the 82 CAHs, or 85 percent, participated in the survey. The results reflected the following top priorities and needs for Iowa CAHs. Scores in the right column are based on a 1 (low) to 10 (high) scoring system.

1. Patient safety and quality	8.7
2. Ability to generate sufficient capital to fund operations and meet future needs	8.5
3. Medicare reimbursement issues	8.3
4. Replacement and/or updating of facilities and equipment	8.3
5. Health information technology (e.g., electronic medical record, CPOE, and bar coding)	8.1
6. Ability to meet community needs and expectations	7.8
7. Compliance with laws and regulations	7.7
8. Physician recruitment and retention	7.4
9. Recruitment and retention of nursing and allied health staff	7.0
10. Expansion of nonacute care services	6.8
11. Ability to deal effectively with competition	6.3

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- > Reviewing cost allocations to nonreimbursable cost centers
- > Ensuring that all allowable costs that qualify for payment are claimed
- > Identifying all costs that are not allowed and ensuring they are excluded
- > Protecting funded depreciation
- > Assigning costs to appropriate cost centers
- > Electing Method II billing, if eligible^a
- > Receiving HPSA and PSA bonus payments as provided for in the Health Insurance Portability and Accountability Act, if eligible^b
- > Capturing all qualifying Medicare bad debts
- > Ensuring proper depreciation is claimed
- > Ensuring all emergency department availability and on-call costs are claimed
- > Reviewing physician contracts and maintaining adequate time records

These measures require continuous monitoring and need to be carefully evaluated. They also may require approval by the fiscal intermediary.

Consequently, proper preliminary planning and analysis is necessary because requests for FI approval must be submitted timely and approved prospectively.

These opportunities for improvement also are associated with pitfalls that can undermine payment levels. Examples include inadequate supporting documentation (e.g., cost finding statistics), idle square footage, unnecessary borrowing, and shared employees working in multiple departments. Potential red flags include advertising, marketing, and fundraising; travel, entertainment, and education costs; political lobbying expenses; physician compensation; physician time records; ED availability and on-call services; physician billing costs; labor-delivery and nursing cost centers; related party and home office costs; physician recruiting practices; and specialty clinics.

a. Method II is a billing option available to CAHs that reimburses them for physician services at 115 percent of the physician's fee schedule.

b. Hospitals may be eligible for a 10 percent bonus if they are in a health professional shortage area and for a 5 percent bonus if they are in a physician scarcity area.

It is imperative that CAHs closely watch for warning signs. Without monitoring, a CAH may experience an unpleasant surprise, such as retroactively denied reimbursement or the Medicare cash flow trap.

5

Avoid the Medicare Cash Flow Trap

A CAH should closely monitor its Medicare interim rates to identify factors that could indicate problems with Medicare cash flow—particularly overpayments. This requires the CAH to be attentive to volume fluctuations, inpatient and outpatient shifts, price increases, cost increases and decreases, new cost centers, and nonreimbursable cost centers.

To ensure the CAH is effectively monitoring its Medicare costs, it should:

- > Prepare interim cost reports
- > Monitor interim rates on a monthly or quarterly basis
- > Review financial statements for illogical or unreasonable trends

If Medicare overpays a CAH and it spends the cash, the CAH may find it extremely difficult to repay the liability to the Medicare program. Further complicating the situation, interest on loans to repay Medicare overpayments is not an allowable cost, and interest rates have increased significantly.

6

Develop Effective Pricing Strategies

Even though CAHs are paid by Medicare on a reasonable cost basis, nongovernmental payers pay these hospitals in a variety of different ways, including full charges, percentage of charges, per diems, and diagnosis-related groups. Self-pay patients also are expected to pay charges unless they qualify for charity care.

Therefore, every CAH should have an effective pricing strategy. The first step in developing such a strategy is to evaluate department gains and losses. To accomplish this, the CAH should prepare a departmental operating analysis to facilitate an

evaluation of which departments are and are not contributing to the financial margins of the hospital and to what extent.

The CAH also should compare its prices with those of competitors in its service area.

Furthermore, the CAH should perform a strategic pricing analysis to determine appropriate pricing increases for departments generating the greatest contributions to the bottom line. The CAH also should review its chargemaster at least annually to verify current and accurate codes. The paramount objective is to optimize the profitability of the CAH's non-Medicare business to meet its financial goals.

7 Improve Performance of Clinics

CAHs that own rural health clinics or physician clinics should periodically review the operations of these clinics. Because physician compensation is a major component of a physician clinic's costs, CAHs should evaluate how physicians are compensated using benchmark resources that are widely available in the health-care marketplace. Physician productivity also

should be reviewed using industry benchmarks. Some hospitals use physician productivity data to establish incentive compensation, as such data often go hand in hand with physician compensation.

CAHs also should review the financial implications of converting freestanding physician clinics to provider-based outpatient clinics. Likewise, clinics that are not designated as RHCs and that qualify under the RHC rules should evaluate the financial implications of converting to RHC status.

Finally, CAHs that provide specialty clinics in their hospitals should evaluate the arrangements with the physicians. In some instances, it may be beneficial to convert those clinics into provider-based clinics and to request that the physicians bill the professional component directly. In other instances, it may be more beneficial for the physicians to rent space from the hospital. The lease agreement, however, must be at fair market value and meet all requirements of the Stark and anti-kickback laws.

8 Manage Labor and Nonlabor Resources

CAHs should continuously monitor labor costs and productivity by comparing their actual values with industry benchmarks. They also should periodically perform salary surveys comparing themselves with state and regional peer hospitals. In addition, CAHs should periodically evaluate employee benefits and modify them as necessary. For example, employee health insurance is currently a major issue because of spiraling health-care costs. CAHs should periodically evaluate employee health insurance programs and tailor them for cost-effectiveness.

Employee turnover also is important. High hospital staff turnover rates can undermine employee morale and cause the hospital to be less competitive. High turnover rates also can result in higher costs because of the need to continually train new employees and contract with agency personnel while positions are vacant. CAHs therefore should periodically conduct employee attitude

SURVEY FINDS ROOM FOR IMPROVEMENT IN RURAL HOSPITALS' STRATEGIC PLANNING

To evaluate the strategic planning initiatives of smaller rural hospitals, BKD conducted a survey of approximately 50 rural hospitals in the Midwest in the first quarter of 2006. A summary of the survey results follows:

	Yes	No
> Does your hospital have a strategic business plan?	80%	20%
> Does your hospital monitor the SBP during the year?	74%	26%
> Does your hospital review and update the SBP annually?	67%	33%
> Does your hospital have an annual board of directors' retreat?	41%	59%
> Is your board well informed and educated on key industry issues?	80%	20%
> Does your medical staff provide input into the SBP?	74%	26%
> Does your hospital prepare a strategic financial plan?	50%	50%
> Does your hospital have a medical staff development plan?	44%	56%
> Is your hospital's budgeting process accurate and timely?	96%	4%
> Does your hospital prepare a capital equipment budget?	96%	4%
> Has your hospital prepared a community health assessment?	44%	56%

Among the most significant results of this survey are the findings that many of these hospitals are *not* conducting board retreats, evaluating financial implications of strategic plans, preparing medical staff development plans, or conducting community health assessments.

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surveys to identify personnel issues that might be contributing to high staff turnover.

CAHs should carefully evaluate their nonlabor costs and policies, as well. Important policies they should consider include restricting who can sign contracts and requiring competitive bidding on purchases. CAHs also should participate in group purchasing contracts and consider cost-sharing arrangements with other hospitals. In addition, CAHs should routinely evaluate make-versus-buy decisions, lease versus purchase decisions, and the reasonableness of administrative operating expense spending decisions, including payments to independent contractors.

9 Evaluate Capital Expenditures and Needs

Many CAHs are in the process of evaluating the age and condition of their physical plants. A number of them have decided to either build replacement facilities or renovate existing facilities because of current favorable economic conditions. The fact that the Medicare program pays on a reasonable-cost basis and is typically the predominant payer is an enticing factor in the decision to build or renovate. Yet building a new physical plant is a strategy that should emerge from the strategic plan. Before proceeding with the new hospital facility or renovation, a CAH should prepare a debt capacity study to determine how much debt it can afford to borrow for such a project.

CAHs also should prepare equipment needs analyses and quantify the financial implications of purchasing new equipment. They should prepare capital expenditure budgets to project planned equipment purchases during a one- to five-year period, including leased equipment. This process not only forces CAHs to project their future needs but it also creates a discipline to avoid spontaneous and haphazard purchase decisions.

10 Evaluate New Products and Services

Successful CAHs constantly evaluate their products and services and look to the future. When evaluating products and services, CAHs should

consider the needs of their communities and patients and the services provided by their competitors. If a CAH is losing a significant market share, it may not be offering the right products and services to meet community needs. An effective process to determine community need is to interview community leaders, physicians, board members, key employees, and other influential community members. Before offering new products and services, CAHs also should evaluate their financial implications, including the effect on Medicare payment.

The Call to CAH Leaders: "Carpe Diem!"

Successful CAHs are progressive, innovative, and efficient. They employ effective business and management strategies and operate their hospitals as well-oiled machines. To gauge your CAH's success, ask probing questions to determine the degree to which your organization is effectively accomplishing each of the 10 strategic steps described here.

If a question receives a "no" answer, consider how it adversely impacts your organization and how a "yes" answer can improve your financial performance. ●

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