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UNIVERSITY MEDICAL CENTER: Plan to fix finances backfires

County auditor's review highly critical of hospital's contract with consulting firm

By MIKE KALIL REVIEW-JOURNAL

Frustrated by the loss of millions of dollars each year at University Medical Center, county leaders 16 months ago approved a dramatic plan pitched by the hospital to boost cash flow.

But the decision to outsource certain key financial operations has increased the hemorrhaging at the taxpayer-supported public hospital, which has lost more than $78 million since 2001.

In a review highly critical of the hospital's contract with ACS Consulting, Clark County Auditor Jerry Carroll concluded last month that UMC administrators did not adequately assess the costs and benefits before outsourcing revenue cycle operations: patient admitting, billing, records management and all other functions affecting the successful collection of money.

Carroll's staff also found flaws in the county's contract that allowed ACS to collect more than $1 million in fees while revenues were declining, despite the fact that the firm was supposedly working on a pay-for-performance basis.

Carroll also said that the ACS agreement was unfavorable to UMC because it did not have a termination clause, standard in business contracts.

Finally, they found the hospital lost money in a deal ACS brokered to sell to a third party UMC's bad debt accounts, languishing patient balances that the hospital has written off after failed collection attempts.

IN THE RED

University Medical Center runs at a financial deficit each year, a problem blamed on its role treating the highest number of indigent and uninsured patients.

However, part of its mission is to sustain itself financially, so that it does not need to be subsidized by taxpayers.

The hospital said last week that its financial statements for the fiscal year that ended June 30 are not available. However, county officials believe that the hospital operated in the red last year.

A look at its losses by fiscal year:

2001 -- $20.7 million
2002 -- $21.8 million
2003 -- $15.2 million
2004 -- $6.2 million
2005 -- $14.2 million

The hospital bungled the transaction, the audit found, inadvertently selling for 1.25 cents on the dollar 3,900 accounts on which patients were actually paying. The deficit-ridden hospital received $10,000 in what amounted to an $800,000 windfall for the third party that sold the accounts. ACS secured a $1.2 million commission for "facilitating" the bad debt sale, the audit said.

In an interview Thursday, County Manager Virginia Valentine acknowledged the internal audit team had uncovered serious flaws in the hospital's outsourcing agreement with ACS, which has been amended twice as a result of Carroll's audit.

"It's a bad contract," said Valentine, chief executive of the county government. "I'm not going to make excuses for it. We've done what we can to improve the contract."

Valentine said the audit has prompted county management to review other unique contracts at UMC, adding that she would spend time with Lacy Thomas, the hospital's CEO, and his staff to review how the contract came about.

"I am concerned because we need to make sure this doesn't happen again," Valentine said. "The concept was good. The contract was problematic. The devil was in the details."

In an interview at his office at UMC, Thomas defended the hospital's deals with ACS and criticized the audit as "unfair" and having a "narrow perspective."

"The audit is a reflection of the past. I've got my eyes on the future," Thomas said. "Things are getting better. I think they (ACS) are making good progress."

Thomas persuaded Clark County commissioners to approve the outsourcing of the hospital's revenue cycle operations in June 2005. The terms of the agreement seemed attractive. The private company would get no minimum fee, just a 25 percent cut of whatever cash it collected over a $29.5 million-per-month benchmark.

In other words, pay for performance.

But ACS did not perform as expected during its first year in control, the audit said, collecting $6 million less during its first year than UMC took in itself the year before. It exceeded its benchmark in only one month.

Though auditors put revenue at $6 million less, UMC wouldn't provide total revenue figures for that year, saying their fiscal 2006 figures still are being audited.

But the company still collected $1.3 million from county coffers because of contract flaws in how its compensation was calculated, according to the audit.

Thomas blamed the falling revenues between July 2005 and June 2006, ACS' first year in control, on a transitional period. ACS spent the first six months of the contract evaluating problems and the next six months implementing fixes, he said.

"You can't walk in, snap your fingers and say things are going to be this way," Thomas said. "It's a work in progress."

ACS Consulting is a unit of Affiliated Computer Services, a Fortune 500 company based in Dallas. Sue Synor, a spokeswoman for the company, directed all inquiries about the audit to UMC.

Thomas presented the Review-Journal with numbers generated by his staff showing revenues improved in the first two months following the yearlong period examined by Carroll.

"Would I like for them to have been successful faster? Sure," Thomas said. "These are problems we are resolving. I believe the end result will be a positive outcome for UMC."

Thomas said he evaluated hospital operations after he was hired to head the hospital in 2003, concluding a private company could manage revenue cycle operations more efficiently than county staffers.

The proposal to enter into the three-year outsourcing agreement was approved by commissioners at their June 7, 2005, board meeting as part of the consent agenda, in which the board takes a single vote on dozens of items considered routine.

This means there was no public discussion or debate among commissioners about the appropriateness of outsourcing day-to-day fiscal operations of a county facility with $400 million in annual revenues.

County leaders typically do not brief county commissioners on most consent agenda items. Commissioners rely on senior county staffers such as Valentine and Thomas to flag matters of importance for them tucked among the thousands of routine items they vote on each year.

"I don't know how much information they had" about the proposal, said Valentine, who was only recently promoted to county manager.

Thomas said he briefed commissioners on the ACS contract and that no one had a problem with it.

"I frankly don't remember if we were briefed specifically, but if Lacy said he briefed us, I'm sure he did," Commission Chairman Rory Reid said. "We are briefed on hundreds and hundreds of items a year."

Thomas conceded there were problems with the initial ACS contract approved by commissioners, a document drawn up by attorneys from UMC and ACS. But he said the flaw that allowed them to collect more than $1 million in fees despite falling revenues has been amended and that UMC also now has contract termination rights.

However, each time UMC received a contract amendment to correct a flaw, ACS was given concessions in return. After two contract renegotiations, the company now receives a $25,000 monthly management fee and the original $29.5 million revenue collection threshold the company needed to surpass to collect fees has been lowered to $27.95 million.

Valentine also had concerns about the structure of the deal under which the hospital sold its bad debt accounts.

She said she did not know why ACS received more than a $1 million commission on the $5.4 million the hospital received for the accounts.

"I don't have an explanation for it," she said. "It's something I'll be discussing with Lacy."

Petitioning the County Commission to approve the deal, Thomas wrote that ACS deserved a cut of the proceeds because "UMC would not have recognized the opportunity to benefit from a sale of this type."

Thomas said he and his staff were unaware there would be buyers interested in bad debt dating back as far as 1986.

"I didn't know there was a market for it," he said. "I did not have any experience with it. It's not a common thing, selling debt this old."

Pressed on whether this merited a nearly 25 percent commission for ACS, Thomas said yes, because the alternative was letting the accounts continue to lapse without payment.

"We got 75 percent of something versus 100 percent of nothing," he said. "They facilitated putting this together."

However, Valentine acknowledged that businesses and government entities routinely sell debt they have little hope of collecting, often without a go-between brokering the deal.

"I don't think it's all that unusual to sell bad debt," she said.

National experts on health care finance confirm it is not unusual for hospitals to unload bad debt for profit.

"It's definitely done," said Richard Gundling, vice president of the Healthcare Financial Management Association, a Westchester, Ill.-based group that is the nation's leading professional organization for health care financial management executives and leaders.

"It's become more and more common to sell bad debt in the last 10 years," Gundling said.

Selling bad debt that is more than a decade old also is not uncommon. It just means the hospital will receive a smaller price for it, said Paul Legrady, director of research at Kaulkin Ginsberg in Bethesda, Md., one of the nation's leading strategic advisory firms serving the debt collections industry.

"It's well known in the health care industry," Legrady said. "Any mechanism that a hospital has to convert bad debt into cash is going to be known by hospital administrators."

Between $3 billion and $4 billion in health care debt is sold each year in the United States, Legrady said.

Although the audit states UMC received $5.4 million for its bad debt through June 30, Thomas said that was only the initial payment. The actual amount was about $8 million, he said.

Thomas said staff errors in preparing the 766,000 bad debt accounts led to 3,900 good accounts being included in the sale, a loss of $800,000 to taxpayers.

UMC routinely runs at an annual deficit, climbing from a $6 million loss in its 2004 fiscal year to a $14 million loss in 2005.

It receives public subsidies to maintain operation, but its mission, according to the county, is to become the hospital of choice in the community, ensure customer satisfaction and move to financial self-sufficiency.

Asked if he considered an $800,000 loss serious for UMC, Thomas bellowed with laughter.

"It'll be offset," he said.

Thomas did not appear to have much regard for the number crunchers in the county auditor's office.

"There are two kinds of people, people who sit back and keep score and risk-takers," he said. "I'm a risk-taker."

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