

# Allowance for Uncollectible Accounts and Contractual Adjustments

*Presented by:*

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## Objectives



- Learn how to calculate the allowance for uncollectible accounts and contractual adjustments
- If you already do this, streamline your allowance estimating process and improve your accuracy

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## Why?



- Patient accounting systems record receivables at gross charges

- The total of your outstanding gross charges is taken directly to the general ledger from the patient accounting system
- An allowance is necessary to adjust the receivables to their net realizable value

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## Why *(continued)*



- Generally accepted accounting principles (GAAP) require receivables to be stated at their net realizable value
  - Audited financial statements **must** follow GAAP
- Cost report settlements are estimated separately

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## Contractual Adjustments vs. Uncollectible Write-offs

- **Contractual adjustments:**

- The hospital does not have the right to collect the amounts charged because they have a contract with a third party to provide the services at an amount different from their standard charges



- **Examples:**

- Medicare, Medicaid, commercial insurance contracts

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## Contractual Adjustment vs. Uncollectible Write-off (continued)

- **Uncollectible write-offs:**

- The hospital is legally owed the amounts charged to the patient but is unable to collect them



- **Examples:**

- Self-insured, deductibles and co-insurance from commercial and Medicare patients

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## Calculating Your Patient Accounts Receivable Allowance

- It is an art not a science
- There is no one way to do this
- Methods used will vary based on:
  - Services provided
  - Payor contracts
  - Patient accounting systems
  - Local economic conditions
  - Business office performance
- **5** Five (somewhat) easy steps to calculate an allowance

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## Calculating Your Patient Accounts Receivable Allowance

(continued)

- **Step 1:**
- Obtain an aged accounts receivable report by payor by aged category
  - Get separate reports for significant lines of service
- **1** **Examples:**
  - nursing home, rural health clinic, physician clinics, home health, hospice, etc.

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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 2:

- Create a spreadsheet template by payor by aging category (example 1)

- Concentrate on your top four to six payors

- Usually Medicare, Medicaid, one or two major commercial insurance, and self-pay

- Consider combining payors that have consistently small accounts receivable balances

- Remove credit balances if they are significant



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 3:

- Assign allowance percentages to each payor class and aging bucket

- Sources for the allowance percentages

- Historical experience
- Interim payment rates
- Contract analysis



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 3:

(continued)

### • Historical experience

#### • Can be obtained from:

- Zero balance reports
- Payment and adjustment reports
- PS&R for Medicare  
(does not include physician services)



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 3:

(continued)

### • Historical experience (continued)

- Positive
  - Easy to obtain
  - Good indicator of payment by financial class
- Negative
  - Historical – may not reflect future payments
    - Significant changes in contract rates
    - Significant price changes
  - An increase in the number of older patient account receivables that are not being written-off can skew the results
  - Transfer of balances between financial classes during the payment process may result in mismatching of payment and write-offs to the accounts receivable



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 3:

(continued)

### • Interim payment rates

- Can be easily obtained from Medicare and Medicaid interim rate letters for hospitals with cost based reimbursement systems
- Positive
  - Accurately reflects what you should be paid
- Negative
  - Does not include payments for physicians made under fee schedule
  - Per diem rates for inpatient and per visit for rural health clinics are hard to translate into a percentage



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

### • Step 3:

(continued)

### • Contract analysis

- Only advised for your significant commercial insurance payors
- Positive
  - A way to check to see if your payments are correct
- Negative
  - May be hard to calculate depending on the provisions of the contract



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

- **Step 3:**

(continued)

- A combination of some or all of the three methods usually yields the best result (example 2)
- Self-pay analysis is usually the hardest payor to correctly estimate



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

- **Step 4:**

- Assign each payor age category an allowance percentage based on your work in step 3 (example 1)
  - Increase the allowance percentage for older aging categories
- The template should then multiply the allowance percentage by the balance of each payor's aging category



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

- **Step 4:**

(continued)

- Summarize the payor allowances in the same categories as your general ledger and evaluate the differences between the recorded allowance and the template



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## Calculating Your Patient Accounts Receivable Allowance

(continued)

- **Step 5:**

- **Checking the allowance calculation**

- Compare your global allowance percentage against your income statement contractual adjustments and write-offs (example 3)
  - The balance should be slightly higher (reflects older accounts that are unprocessed)
- If you are preparing frequent allowance estimates you can compare net patient service revenue to cash collected from patient services
  - The amounts should be within a few percentage points of each other



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## How Often Do I Do This?

- Calculate the allowance using a new accounts receivable report monthly
- Consider updating the allowance percentages at least quarterly



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## Questions?



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