A Dark Daily

White Paper

Clinical Laboratory and Pathology News/Trends

A CEO's Guide to Increasing Laboratory Valuation:

Effective Revenue Cycle and Compliance Management are Critical Success Factors

By:

E. Victor Brown

Table of Contents

INTRODUCTION:

REVENUE CYCLE MANAGEMENT IN THE LAB

Despite its complex and elusive nature, maximizing laboratory reimbursement has always been the untapped reserve that leads to increased valuation.

The laboratory industry has been in a state of consolidation for the past 20 years leaving far fewer independent labs than just a decade ago. Frequent regulatory and compliance rules changes, tightening margins, and a severely weakened economy increases the pressure on potentially acquirable labs to find immediate ways to increase revenue and operating margin. On the other side of a transaction, the acquiring lab needs to rapidly realize synergies and quickly grow the top line of the acquisition to offset the typical post acquisition declines.

Despite its complex and elusive nature, maximizing laboratory reimbursement has always been the untapped reserve that leads to increased valuation. In order to successfully navigate the financial and regulatory pitfalls of the current landscape, laboratories of all sizes must turn to revenue cycle management (RCM) as the fastest route to that goal. However, increasing valuation through maximized reimbursement requires CEOs and CFOs to have a unified understanding of what RCM is and is not.

...true RCM is not just about billing. It is about managing the entire revenue cycle. That means a constant and consistent analysis of front-end to back-end revenue processes, tools and workflows.

How well a lab manages these processes, workflows and tools will determine its ability to capture all potential revenue and increase its valuation.

Revenue Cycle Management is one of those overloaded terms that many vendors use, but can mean as little as submitting a claim. However, true RCM is not just about billing. It is about *managing the entire revenue cycle.* That means a constant and consistent analysis of front-end to back-end revenue processes, tools and workflows. Since the desired outcome is to not leave any earned revenue on the table, RCM comes down to maximizing the efficiency and adaptability of all three for greatest net return.

Up to 40 percent of laboratory claims have missing or inaccurate information which can lead to delays, denials and often time write offs. CMS statistics indicate that only half of denied claims are ever returned for processing. It is these exception claims and an inaccurate net verses gross revenue recognition that negatively impacts the lab's revenue and may cause labs to lose up to half of their profits from the billing process alone.

In laboratory, compliance is a critical component of true RCM and an area where labs may not be aware of their oversights until it is too late, and then the costs can be enormous. Comprehensive revenue cycle management will address these compliance issues that can not only cost a lab in heavy fines and legal fees, but will take them out of contention for future acquisition. Any lab under a cloud of OIG investigation for non-compliance will not only lower their perceived and actual value, but will scare investors away outright. Ultimately, effective compliance management eases the due diligence process, reduces the acquirer's risk and demonstrates a well run lab.

How well a lab manages these processes, workflows and tools will determine its ability to capture all potential revenue and increase its valuation.

CHAPTER ONE:

WHAT ELEMENTS DRIVE LAB VALUATION?

Laboratory valuations are primarily based on multiples of sales and EBITDA.

Laboratory valuations are primarily based on multiples of sales and EBITDA. The first priority is maximizing revenues with growth rates and earnings following closely in importance.

Determining Net Sales

Net sales represents the amount of sales generated by a company after the deduction for returns, contractual allowances, damaged or missing goods and any discounts allowed. Deductions from gross sales are represented in the net sales figure. The sales number reported on a company's financial statements is a net sales number, reflecting these deductions. Therefore, net sales gives a more accurate picture of the actual sales generated by the company, or the cash that it expects to receive.

Specifically in the case of laboratories deductions from gross sales would include contractual allowances to payers. These contractual allowances can average as much as 60%. A proper billing/AR system can increase net sales by 6 – 10% by reconciling estimated and actual contractual allowance data. In addition, reducing claim denials and processing errors can result in an additional 6 – 10% increase in net sales.

Common approaches to business valuation include review of financial statements, discounting cash flow models, and similar company comparisons. In the case of laboratories valuations are commonly based on multiples of net sales and EBITDA.

Determining EBITDA

EBITDA can be used to analyze and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions.

EBITDA is essentially Net Income with interest, taxes, depreciation, and amortization added back to it. EBITDA can be used to analyze and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions. EBITDA is a non-GAAP measure that allows some amount of discretion as to what is included in the calculation. EBITDA came into common use as an indicator of a company's ability to service debt. EBITDA is now commonly quoted by many companies, especially in the technology and health care sectors. Since the discretionary accounting and financing effects on company earnings do not factor into EBITDA, it is a good way of comparing companies within and across industries. This measure is also of interest to a company's creditors, since EBITDA is essentially the income that a company has free for interest payments. EBITDA does however leave out the cash required to fund working capital and the replacement of old equipment.

Reduction in bad debt expense achieved with a proper billing/AR system also improves EBITDA.

In addition to maximizing net sales, reducing operating costs will also improve EBITDA. Laboratories experience expense synergies in the IT and billing departments with a proper billing/AR system. This is in addition to cost synergies achieved as a result of eliminating duplication of functions. Reduction in bad debt expense achieved with a proper billing/AR system also improves EBITDA.

Despite the restrictive revenue recognition guidelines of SOX, many labs today still struggle with precise accounting of net revenue, which remains the primary focus of any due diligence effort. In fact, labs have neither an accurate top line nor a maximized bottom line primarily due to the inaccurate accounting of the contractual allowance and the consequent miss statement of bad debt. Fortunately, the billing process is responsible for both and management attention to this process can have an enormous impact on value. An acquirer of a laboratory has the opportunity to increase revenues post acquisition through proper revenue cycle management. Such an immediate improvement in the ongoing business is critical during a transition period where short term revenues may decline. Expense synergies in the IT and billing departments reduce operating costs in addition to other cost synergies achieved as a result of eliminating duplication of functions. Cash flow will also improve through access to real time accounts receivable information and a proactive collection policy.

However, as billing, collections, and compliance continue to grow in complexity, so does the difficulty in management of the revenue cycle.

A basic premise of effective management is that what gets measured gets done, making precise revenue recognition the cornerstone upon which increased lab valuation must be built. Billing/AR systems today must possess financial sophistication and the ability to provide GAAP compliant financial reporting. They require greater drill-down detail, monitoring capabilities and adaptability to ever-changing requirements..

A basic premise of effective management is that what gets measured gets done, making precise revenue recognition the cornerstone upon which increased lab valuation must be built.

When it comes to the difference between the retail and the negotiated third-party contractual agreement rate, few billing/AR systems and operators are capable of constantly monitoring what is billed, what is paid and its exact correlation to contractual allowance.

Although CEOs understand the concept of revenue recognition, the practice is far more elusive. When it comes to the difference between the retail and the negotiated third-party contractual agreement rate, few billing/AR systems and operators are capable of constantly monitoring what is billed, what is paid and its exact correlation to contractual allowance. This challenge is exacerbated by changing Medicare and third-party payer rules, primary and secondary payment guidelines, regulations and fee schedules spread across hundreds of payers and thousands of Current Procedural Terminology (CPT) codes.

Despite the plethora of third party payers, the world of compliance revolves around Medicare rules and guidelines. Due to this fact, the most important determining factor in Medicare billing are the rules and regulations defined by the Centers for Medicare and Medicaid Services (CMS) and the OIG.[1] Underbilling or overbilling due to claims errors raises flags with federal agencies that see them as regulatory guideline violations that are potential fraud.

Section Five of "**Laboratory Medicine: A National Status Report**," released by the Centers for Disease Control (CDC), spells out the coverage problem succinctly: "*Most Medicare coverage policies for new tests and services under Part B are established by local carrier advisory committees and are known as local coverage determinations (formerly referred to as local medical review policies). In this decentralized system, there is substantial variation among coverage policies of different carriers.*"[2]

Failing to do so will not only reduce potential captured revenue, but puts a lab in the position of incurring massive fines for inaccurate revenue reporting.

It is for this reason and others that labs must have accurate coding to avoid compliance issues and claim rejection. Failing to do so will not only reduce potential captured revenue, but puts a lab in the position of incurring massive fines for inaccurate revenue reporting. Appropriate revenue cycle management includes underlying transactional detail and audit trail data for the establishment of policies and procedures that can be effectively tested and documented for SOX compliance as well as guide steps of corrective action if needed.

CHAPTER TWO:

RCM CHALLENGES IN THE LAB

Many labs do not realize the depth of their non-compliant activities and how that can have a profound impact on valuation.

Compliance and Fee Schedules

Many labs do not realize the depth of their non-compliant activities and how that can have a profound impact on valuation. In the eyes of the Office of the Inspector General (OIG), a mistake by the billing staff is not distinguished from fraud. The way that the OIG classifies fraud and abuse no longer requires proving intent. There are serious penalties for fraud in healthcare that can attach treble damages to the already hefty damages of $10,000 per claim. The low dollar amount of the average laboratory testing claim of, say, $40.00 could result in potential damages in the amount of $30,000 for a single procedure code.

Even large labs misclassify a lot of their revenue as bad debt by taking revenue adjustments when they should be expensing it.

Even large labs misclassify a lot of their revenue as bad debt by taking revenue adjustments when they should be expensing it. Consequently, they believe bad debt to be very low, but it is just buried in the contractual allowance calculations. The result is understated revenue and bad debt.

Coding Challenges

There are thousands of combinations of codes and scenarios where some can be billed and some cannot. These codes, the associated fee schedules from CMS and the contractual fees from hundreds of third party payers make for a complicated process that requires great attention to detail and constant reevaluation and updating.

Today's billing/AR systems almost universally allow some flexibility in setting up individual testing codes and associated fees. Unfortunately, the limitations of many of these systems correlates these individual and combination codes to a billing amount that meets generalized rather than specific payer rules. The result can be rejected claims by some payers and an under charge to others that leaves reimbursement dollars on the table.

All of these factors pose significant risk to a lab's claim error rate, compliance as well as top line revenue.

The alternative is to manually set each testing code reimbursement rate (and the different or multiple code combinations that often arise with more complex assays) for each of hundreds of payers. Once again, this introduces potential error into the coding and the eventual billing process that could lead to what appears to be fraudulent claims, or, leaves behind reimbursement dollars.

Then there are the challenges posed by the upcoming October 1, 2013 deadline for conversion to ICD-10 CM and the January 1, 2012 conversion deadline for updated standard for Health Insurance Portability and Accountability Act (HIPAA) electronic transactions – the ANSI X12 standard, Version 5010. The conversion costs for labs have been estimated to range from hundreds of thousands into the tens of millions.

Most labs will rely on traditional billing/AR system and software vendors to handle these updates. Unfortunately, many vendors cannot guarantee sufficient provisions for support, rapid implementation, testing and troubleshooting. All of these factors pose significant risk to a lab's claim error rate, compliance as well as top line revenue.

Workflow and Manual Processes

As a result, the billing clerks are making different non-standard decisions throughout the day as they look at various digital data or pieces of paper on a routine billing system or system report.

Managing account receivables is about accuracy and timeliness, with both dependent on workflow. With labs representing just 2 percent of healthcare spending but 30 percent of all claims filed, they see some of the smallest margins in healthcare. This means that manual processes and inefficient labor usage can further erode an already thin margin. Tracking the 40 percent of problem claims and correcting them in real time introduces further possibility for human error. This is due to lack of visibility and categorization of problem claims as well as reliance on manual processes for follow-up.

As a result, the billing clerks are making different non-standard decisions throughout the day as they look at various digital data or pieces of paper on a routine billing system or system report. The preponderance of paper in the form of explanation of benefits (EOB), front-end rejection reports, et al. not only slows the workflow but introduces errors and compliance problems.

These challenges manifest themselves in ways beyond valuation as acquiring labs are not only looking at the top and bottom line, but the processes of the potential acquisition in terms of billing, collections and compliance.

These acquiring labs must find immediate ways to eliminate the duplication of functions, lower bad debt and recover more cash to offset the decline.

The largest and most sophisticated acquiring labs may choose to convert an acquired lab to its own standardized national billing/AR systems. As prime targets for acquisition decrease, even the largest acquiring labs are grappling with corporate billing/AR conversions that take far too long — even in the best-case scenario — and risk high conversion losses in the process.Since one can expect the revenue from an acquired lab to decline as much as 25 percent post acquisition due to contract overlap and physician loyalty, the need to maximize revenue capture becomes even greater. These acquiring labs must find immediate ways to eliminate the duplication of functions, lower bad debt and recover more cash to offset the decline.

CHAPTER THREE:

POSITIVELY IMPACTING LAB VALUATION THROUGH RCM

Implementation of comprehensive RCM begins with an assessment of the process tools (Technology Infrastructure); the process itself (Data Processing/ Accessibility) and finally the workflows that replace manual processes and workarounds.

In the lab business environment, processes and workflows are shaped, to a large degree, by process tools in the form of Information Technology (IT). When IT is slow to adapt or evolve, or simply cannot do either, the result is manual workarounds and the introduction of human error.

Implementation of comprehensive RCM begins with an assessment of the process tools (Technology Infrastructure); the process itself (Data Processing/Accessibility) and finally the workflows that replace manual processes and workarounds. This assessment reveals manual process gaps in the IT infrastructure that can then be addressed. Chiefly through software automation tools that provide rules based workflow, decision support, and financially sophisticated informational databases.

Technology Infrastructure

The current complexities of lab billing/AR may require as many as 50 necessary functionality updates per month just to stay current with payer rules, coding and compliance needs.

Many labs utilize "proprietary" billing/AR systems/software that, according to the OIG, are highly susceptible to fraud issues.[3] In the published OIG Report on "Medical Billing Software and Processes Used To Prepare Claims"(3) the OIG states that "Software developed for a single individual or a [provider] probably poses the greatest risk of financial harm to the Medicare program" and "Proprietary software, and not commercial software, poses the greatest risk of being intentionally designed to produce improper or inaccurate claims."

Like many other industry verticals have already learned, IT software and design will never be the core competency of their business, despite even Herculean internal efforts or the amount of resources devoted to this endeavor. The current complexities of lab billing/AR may require as many as 50 necessary functionality updates per month just to stay current with payer rules, coding and compliance needs. This is an unsustainable burden for even the largest players on the laboratory landscape to handle independently.

With the bulk of capital expenditures going to diagnostic information technology, labs are not in the position to make equal investments in best-of-breed financial IT infrastructure. The result is that IT personnel are consumed with keeping up with and maintaining the diagnostic IT systems while scant personnel and capital resources can be dedicated to the financial systems side. This makes it difficult to stay current with technology and the ever-changing needs of billing/AR departments.

Best in Class Revenue Cycle Management

For Laboratories that decide to pursue best in class Revenue Cycle Management as a means to increasing valuation, the following list of capabilities represent the minimum requirements they should look for when evaluating a solution.

- **Order Entry** — full billing screen that can easily create an entire claim, or can create a claim by accessing data available in other modules (i.e. pricing, coding etc. modules)
- **Price Modeling** — analysis and manipulation of any desired pricing strategy by client, payer type, or in aggregate.
- **Pricing** — complete pricing flexibility including unlimited special pricing, discounting, fee schedules and payer specific expect pricing capability.
- **Error Processing** — automatic and systematic management of unbillables and rejections.
- **Cash Posting** — electronic remittance through electronic transmission or, where unavailable, scanned EOBs and/or lockbox operations.
- **Capitation** — carve-out billing, utilization tables that track contract specific payment rates by utilization, contract payment requirements and eligibility tracking.
- **Accounting** — GAAP compliant detail of gross and net sales, adjustments, write-offs and cash payments.
- **Dialysis** — setup dialysis patients for processing and editing billings to segregate composite billing in synchronization with carrier specific criteria.
- **Patient Demographic and Standing Order** — demographic and/or medical database for repeat patients
- **Secondary Insurance** — electronic generation of secondary claims when the provider is also using an imaging system to retain paper documents electronically.
- **Electronic Record Retention** — retains electronic and scanned paper documents for permanent record storage in an easily accessible format.
- **Refund** — work credit balances and generate refunds and adjustments automatically through the system.
- **Compliance** — rules based workflows and built in compliance checking. Automates decision making to relive clerical staff of compliance related decisions.
- **Edits** — minimum monthly system updates to maintain changes in payor edits or compliance changes

Billing/AR systems capable of only handling straightforward billing and accounts receivables are not only outdated, but dangerous to the business of running a lab.

Billing/AR systems capable of only handling straightforward billing and accounts receivables are not only outdated, but dangerous to the business of running a lab. Automation is the key to consistent and standardized claims exception handling.

This relieves the lab from relying on the manual decisions of the billing clerk in a very complex regulatory environment.

Even the largest labs that have traditionally grown through acquisition find themselves struggling with inadequate levels of billing, coding, collections and compliance system automation. For them, the goal of realizing synergies from an acquisition takes far too long due to increasing complexities and in some cases lab specialization. Consequently, they face the choice of hugely expensive system rebuilds or finding adaptable solutions that address these challenges.

Billing/AR systems and software must have integrated rules with automated compliance checking so that the same issues can be handled in the same manner every time.

Data Processing

With increased pressures on test reimbursement, CEOs need to be able to monitor key indicators such as profitability by payer, profitability by provider, and other management data that are necessary to strategically manage the business. Robust systems should include features such as automated eligibility checking, automated flagging of potential denials, comparison of remittances against contract expect pricing, electronic payment posting, and multiple secondary payer management processing among others.

This level of automation requires rules engines that are capable of standardizing protocols every time a message is electronically received by the system from payers, front-end order entry systems or clearing houses. Billing/AR systems and software must have integrated rules with automated compliance checking so that the same issues can be handled in the same manner every time.

www.darkdaily.com

Most electronic systems basically let claims age within the system, but the best billing/AR systems actively review and manage submission deadlines. They then flag problems, such as when a payer should have paid and how much. This allows billing staff to monitor and deal with potentially aging claims in real time rather than after the fact.

...the best billing/AR systems actively review and manage submission deadlines.

System Delivery

How the billing/AR system is delivered to the laboratory is critical to its long term success. The laboratory billing process is complex and in a state of perpetual change. While the cost of on-premise software may be attractive, the cost of managing the changes and maintenance is extremely high. Many labs cannot keep up with the level of change and their IT teams inevitably get behind, which only leaves money on the table and exposes them to compliance liabilities. In The Pastin Report on Health Care Compliance Programs, the Council of Ethical Organizations (a non-profit compliance "watchdog" group) recommended XIFIN as the only laboratory billing solution that provides a practical means for managing compliance requirements.

Software as a Service

Software as a Service (SaaS) is a software deployment method where the provider licenses an application to customers for use as a service on demand. The application is typically hosted on the vendor's remote servers and is accessed through secure protocols via the Web. The software vendor essentially becomes the billing IT staff for the client laboratory and automatically provides updates, improvements and decision support to the client through the Web-based application. This arrangement creates certain advantages and can contribute to continuous improvement.

One of the most prevalent users of SaaS is the banking and financial services industry. Financial services leaders such as Merrill Lynch, SunTrust, Bear Stearns, Aon and many others utilize SaaS for both core and non-core process such as CRM, electronic billing, cash management, core financial accounting, tax management (both state and sales), budgeting, governance risk and compliance (GRC) and business intelligence (BI).

SaaS-enabled managed services are virtually ubiquitous with smaller banks relying on larger banks to process loans. In fact, a majority of the IT applications for smaller banks are delivered via the SaaS model for activities like expense reporting and payroll.

The fact that SaaS is dynamic, continuously updated and requires no purchase or maintenance of hardware, software or special personnel competencies means CEOs can reap all the benefits of on-premise software without any of the typical downsides.

Traditional on-premise software is inadequate for the laboratory environment as the licensed software is obsolete the day it is installed.

Traditional on-premise software is inadequate for the laboratory environment as the licensed software is obsolete the day it is installed. Even though upgrades are offered periodically, these are often months or sometimes years after they are needed, forcing the user to resort to costly manual work arounds. The circumstances are further exacerbated when the cost adverse laboratory does not adopt timely upgrades. The result, common to most labs today, is a grossly out dated infrastructure that now requires a complete and very costly over haul. The primary strength of the SaaS (Software as a Service) model is that all of this is eliminated by its very nature. For instance, the model allows SaaS based Revenue Cycle Management Vendor XIFIN Inc. to employ their engineering staff, dedicated to ensuring the system is always up to date, while sharing the maintenance costs across many clients. In addition, the XIFIN SaaS based system processes over 4 million claims per month across a diverse set of laboratories and tests and is continually optimized to deliver a best in class solution to all customers.

Healthcare in general and laboratories in particular are late converts to the SaaS model.

The SaaS model hosts the billing/AR system in a secure facility and makes the application accessible to clients via a standard Web browser. The security, full redundancy and geographically separated disaster recovery site far surpasses the level of security and redundancy of most on-premise servers.

Healthcare in general and laboratories in particular are late converts to the SaaS model. While this model is gaining in laboratory converts it is already a proven and established model with many fortune 500 companies utilizing SaaS for major financials.

CHAPTER FOUR:

Case Study

LABCORP ACQUISITION OF US LABS

In 2002, Irvine California-based US Labs was endemic of the struggle that all independent labs go through to reach the destination of accurate revenue recognition, compliance and increased valuation. A trailing 12-month revenue in the millions, EBITDA in the negative millions and two successive years of write downs for overstated revenues were all severe roadblocks. This was capped off by an OIG investigation of billing practices that was eventually dropped, but still cost the company hundreds of thousands in legal fees.

US Labs — Irvine California
Esoteric oncology and hematopathology
Acquired by: LabCorp
~$70M annual revenue
20% annual growth rate
Acquired: 12/18/2004
Implemented XIFIN RCM: 06/10/2003

Under new CEO Judd Jessup and CFO Steve Pierce, the venture-backed cancer diagnostic testing laboratory underwent a fifteen-month overhaul of billing processes and workflows. The result was an annual 20 percent growth rate resulting in gross revenues of 74 million by early 2005.

Unfortunately, the dramatic growth brought a steep increase in late billing submittals and errors. The specific cause was that the legacy billing/AR system's manual process gaps made it difficult for staff and infrastructure to accurately track retail verses contractual rate for hundreds of payers.

Further scrutiny revealed that the inaccurate contractual allowances had been misclassified as bad debt.

Consequently, the lab was unable to obtain definitive net revenue. Further scrutiny revealed that the inaccurate contractual allowances had been misclassified as bad debt. "It was obvious that we had exceeded the abilities of our legacy proprietary billing system and had to find an adaptable long-term solution to get back on track financially," said Pierce.

Solution

They each expressed dissatisfaction with manual revenue cycle processes, yet none had found a suitable replacement.

Almost overnight, Pierce was dealing with a legacy billing/AR system unable to adapt to volume, eliminate manual errors and effectively meet compliance needs. He first consulted counterparts at four similar labs to assess their billing systems and look for recommendations. All four labs were utilizing billing/AR modules that were part of an established manufacturer's LIS. They each expressed dissatisfaction with manual revenue cycle processes, yet none had found a suitable replacement. "One of the four however, had investigated XIFIN, a Software as a Service (SaaS) billing/AR solution, and recommended it to me," said Pierce.

At first, Pierce had significant concerns with a SaaS model where part of the billing operations would be located off site. Concrete examples of success with other labs and Pierce's prior knowledge of Lale White's (XIFIN's CEO) longstanding immersion in the lab billing /AR world sealed the deal for him and Jessup. "Because of Lale's experience, I had much greater confidence in XIFIN's ability to assure compliance on our behalf than any of their competitors," said Jessup

The four-month process and the solution's maximized automation allowed the lab to reevaluate all of the contracts to define actual contractual rates.

Implementation and rollout

The implementation process began with appointing the billing director as project manager and the lab's VP of IT as collaborator. A billing staff task group worked with XIFIN to reload all payor contracts and billing information. The four-month process and the solution's maximized automation allowed the lab to reevaluate all of the contracts to define actual contractual rates. "The process gave us the personal assurance that we were getting good data in and out of the system with correct bills, codes and a definitive trust in the net revenue number," said Jessup.

During the process, IT leadership made several trips to XIFIN's San Diego facility to assess XIFIN's operations and work out technical issues during the transition.

"Very shortly after giving the billing director the criteria, he quickly returned with a list of several reports that I began receiving daily, weekly and monthly as needed."

XIFIN made personnel available for issues resolution through all transition phases. Reports from IT leadership provided Pierce with the assurance of the stability, safety and integrity of utilizing a SaaS solution.

Results

Unlike the lab's previous billing/AR system, the XIFIN solution had the capability of providing detailed reports on all aspects of the revenue cycle at any interval desired. Pierce compiled a list of report needs including valid revenue recognition, submitted but unpaid claims, payment intervals per provider and those indicating any problems with billing. "Very shortly after giving the billing director the criteria, he quickly returned with a list of several reports that I began receiving daily, weekly and monthly as needed," said Pierce.

Over the next year, overall cash collections increased 8 percent while billing-related IT investments and expense were reduced by over 90 percent.

Despite its own national corporate billing system, LabCorp felt confident with the XIFIN solution and decided to keep it in place for the newly acquired US Labs.

Over the next year, overall cash collections increased 8 percent while billing-related IT investments and expense were reduced by over 90 percent. At the time of the transition, billing FTEs numbered 27 with a pre-XIFIN forecast of an additional 10 FTEs over the next year to handle the projected growth. "We ultimately didn't have to add a single FTE, which is a testament to XIFIN's level of automation and workflow streamlining," said Pierce.

Mergers & Acquisitions

Late in 2004, US Labs received acquisition interest from North Carolina-based LabCorp. As one of the nation's top two largest lab corporations, they were no stranger to the big issues of revenue recognition. During the due diligence process, LabCorp officials looked at bad debt reserve, EBITDA, net receivables and other key indicators of the revenue process and found no problems at US Labs.

Despite its own national corporate billing system, LabCorp felt confident with the XIFIN solution and decided to keep it in place for the newly acquired US Labs. Shortly thereafter, Both Jessup and Pierce moved to board positions at other companies but were not surprised at LabCorp's post-acquisition decision. "Acquiring labs are looking for quality, so the business systems and infrastructure that support day-to-day operation of the company are extremely important to them," said Pierce.

http://carolinanewswire.com/news/News.cgi?database=topstories.db&command=viewone&id=2343&op=t

Case Study

PARTHENON CAPITAL ACQUISITION OF WESTCLIFF MEDICAL LABORATORIES

California's healthcare and laboratory market has long been a bellwether for changes that eventually transform the national landscape. By 2004, Westcliff Medical Laboratories had grown into the largest independent clinical lab in the southern part of the state by reacting to those changes early and decisively. However, growth also tends to reveal inefficiencies such as a marginal legacy billing system with too many manual processes that require ever increasing amounts of labor.

Westcliff Medical Laboratories — Santa Ana California
Independent Clinical Laboratory
Acquired By: Parthenon Capital
~$100M annual revenue
20% annual growth rate
Acquired: 06/30/2006
Implemented XIFIN RCM: 09/20/2005

The lab's legacy billing/AR system software required manual review of claims, provided no claims visibility and could not facilitate accurate monitoring of collections for a growing list of accessions and clients. "Without the ability to accurately predict net cash flow, we had to keep a lot more cash in reserve," said then Westcliff CEO Rick Nicholson.

In addition, vendor upgrades were neither timely nor fully explained operationally. A program rewrite resulted in the system's failure to send out medical bills for sixty days. Despite a second rewrite and eventual recovery of the revenue, the lost time had delayed financial decisions and jeopardized compliance.

Westcliff realized that continued growth would be impossible without accurate revenue recognition and greater automation of the billing/AR system software, so the search for a solution began before year's end.

Without internal legacy system report functionality, the lab had to rely on vendor-run queries and Excel spreadsheets. The alternative was month-end snapshots that only showed what had been billed. With no audit trail, compliance was nearly impossible as changes within the system could not be identified or traced to their point of origin. Westcliff realized that continued growth would be impossible without accurate revenue recognition and greater automation of the billing/AR system software, so the search for a solution began before year's end.

Solution

The majority of potential vendor solutions that were reviewed made claims of improved billing/AR process and collections without quantifiable proof. However, one vendor solution, XIFIN, utilized a Web Based SaaS approach to its software. This intrigued both Mr. Nicholson and his VP of AR. "I was familiar with Lale White, XIFIN's CEO and her long track record in billing collections and coding," said Nicholson. "XIFIN made a number of definitive projections for collections and process improvements that I wasn't hearing from their competitors."

In the end, Mr. Nicholson trusted in the experienced opinions from his VP of AR and moved forward. "I believe in reports, but you have to believe in the people that run the system, and I had 100-percent trust in my accounts receivable VP," said Nicholson. She was ultimately satisfied with the evidence and the software itself, so we moved forward."

"The reports gave us predictability and the ability to manage the growth of the company through confident revenue recognition."

Between the time of post implementation and acquisition, revenue increased by 15 percent while days outstanding were reduced by 52. Billing department productivity increased by 40 percent…

Implementation/Rollout

Nicholson placed project control of the implementation and rollout under the CIO and VP of AR. Westcliff saw immediate benefits including a major reduction in IT support to manage files and run reports.

While Mr. Nicholson concentrated on management of cash flow, net revenue and financial statements, his VP of AR monitored collections, bad debt metrics, auditing and process flow via system reporting capability. Over the next several months, the lab gained the ability to accurately predict net revenue from XIFIN's detailed payment posting capabilities. "The reports gave us predictability and the ability to manage the growth of the company through confident revenue recognition," said Nicholson.

The rules-based workflow of XIFIN's system demanded and facilitated more upfront compliance through prompts and information requirements for the billing and claims process. A daily summary report showed error queue billings as well as notification of filing limits for those claims with missing billing information. Additionally, the XIFIN system automatically generated work lists for the billing staff. It also allowed input of narratives that lacked the specific ICD-9 codes so that they could be matched to proper codes.

Over the next six months, XIFIN's predictions for collections, revenue increases and other metrics were met or exceeded. Between the time of post implementation and acquisition, revenue increased by 15 percent while days outstanding were reduced by 52. Billing department productivity increased by 40 percent, allowing repurposing of some employees to other departments.

M & A

In the first quarter of 2006, investment firm Parthenon Capital spearheaded the merger and acquisition of Westcliff Medical Laboratories and the smaller Health Line Clinical Laboratories.

With profits and collections increased significantly by the end of 2005, Westcliff began looking at how increasing margin pressure would affect continued growth. "I began seriously entertaining offers of acquisition as a way to recoup some of my own investment, fund future growth and ensure the future of my employee base," said Nicholson.

In the first quarter of 2006, investment firm Parthenon Capital spearheaded the merger and acquisition of Westcliff Medical Laboratories and the smaller Health Line Clinical Laboratories. The process began with the operational integration of Health Line into Westcliff, which was aided by the ease of implementing a new acquisition onto the XIFIN system. This culminated in the acquisition of the now larger Westcliff into a new clinical laboratory holding company known as BioLabs, Inc.

According to Nicholson, the due diligence process went as smoothly as any such process could go. This was attributed to the XIFIN system facilitating easy access to reports, audit trails and all other claims data. "XIFIN had a big part in making us look more attractive, not only from a profit point of view, but also from how well we were run from an AR perspective," said Nicholson.

http://www.parthenoncapital.com/news_result.asp?id=66

Case Study

SONIC HEALTHCARE LTD. ACQUISITION OF PIEDMONT MEDICAL LABORATORY

Today's small independent laboratories face a more uncertain financial future than in any time in recent history. The ability to remain viable and increase valuation in the long term will surely be impacted by the outcome of impending national healthcare legislation. The ability to quickly recognize net revenue and maximize collections is the surest way to growth and potential future mergers and acquisitions.

Piedmont Medical Laboratory

Piedmont Medical Laboratory — Winchester Virginia
Full Service Clinical Laboratory
Acquired by: Sonic Healthcare Ltd.
~$11M annual revenue
Acquired: 08/12/2009
Implemented XIFIN RCM: 04/09/2008

As a joint venture for-profit laboratory, Virginia-based Piedmont Medical Laboratory (PML) saw the handwriting on the wall early in the decade. Formed in 1991 by Virginia's Valley Health, the full-service clinical lab's growth was hampered by a manual billing/AR system and lack of electronic connectivity to its clients. By the mid decade, PML had tackled the connectivity dilemma, but the billing challenges had yet to be fully addressed. "The legacy billing/AR system was all manual operation and tracking in terms of bad debt, days outstanding etc. with few third party payer interfaces, so we had definite concerns about maximized collections, remittances and adequate reporting," said PML CEO Joe Skrisson.

"We could not get reports that dealt with medical necessity concerns, rejections and other critical areas that would ensure compliance and increase cash flow," said Skrisson. That prompted us to look for a more automated solution."

Before Skrisson's arrival in 2004, PML had seen some serious challenges to the billing system's operation that had slowed bill payments for several months. While this was ultimately resolved, the board of directors still harbored major concerns. Once the client connectivity issues were resolved, Skrisson began scrutinizing the continuing challenges to the billing/AR system. "We could not get reports that dealt with medical necessity concerns, rejections and other critical areas that would ensure compliance and increase cash flow," said Skrisson. That prompted us to look for a more automated solution."

Solution

PML began a review of billing/AR marketplace offerings and found many solutions that seemed outdated. Others were more forward thinking in terms of technology but provided no verifiable results of collection increases and better compliance. In addition

to these attributes, Skrisson felt it very important to find a vendor with a culture of proven knowledge and results in billing/AR.

After reviewing several completely outsourced approaches, PML selected the XIFIN system that blended outsourced functionality and in-house internal control. "XIFIN's Web-based solution provided instantaneous updates, decision support, comprehensive reporting and other important automation functionality," said Skrisson.

Mr. Skrisson concentrated on cash recovery reporting while the CFO received and monitored the reports detailing accounts payer mix and line item revenue.

"The reports broke things out very conveniently by client and payer, which allows you to analyze what marketing/sales told you the account was going to generate verses what it actually produced."

Implementation/Rollout

PML had been fortunate to find a CFO who also had the experience in billing and collections to be in charge of billing operations. "She had intimate knowledge of everything from monthly financial reports and workstation operations down to the minutia of the billing operation," said Skrisson. This allowed her to work closely with our billing supervisor, thereby minimizing the number of people involved in the evaluation and implementation process."

The CFO's broad billing/AR experience made her the ideal choice for project manager. This allowed Skrisson to concentrate on marketing and sales aspects of the business. Although the XIFIN system provided detailed daily, weekly and monthly reports, Mr. Skrisson concentrated on cash recovery reporting while the CFO received and monitored the reports detailing accounts payer mix and line item revenue.

By late 2007, PML was experiencing a 10 percent increase in cash recovery and a significant drop in AR days outstanding that exceeded XIFIN's estimates. The results and the ongoing reporting functionality allowed PML to look forward from a position of stability and growth. "The reports broke things out very conveniently by client and payer, which allows you to analyze what marketing/sales told you the account was going to generate verses what it actually produced," said Skrisson. "This gave us the ability to look at our client portfolio and identify those clients that needed improvements."

M & A

PML had been the target of M & A interest for a number of years due to market positioning in terms of payers and geography. By early 2009, the lab ownership began entertaining select offers with Sydney, Australia's Sonic Healthcare Ltd. topping the list.

PML had been the target of M & A interest for a number of years due to market positioning in terms of payers and geography.

With yearly revenues exceeding $11 million, PML ownership decided that it was time to divest the lab after eighteen years of ownership. Among the many reasons making this an ideal time for Valley Health to sell PML was the attractiveness of the offer and a long-range plan to reinvest in its healthcare systems. "I'm sure that Valley Health was looking at the future unknowns of where the healthcare market was going in terms of national health insurance and other factors that could potentially affect the lab's future value," said Skrisson.

As of this writing, the final acquisition of PML was just weeks old, so few details of the due diligence process and its duration were not available for release. What Mr. Skrisson was able to say definitively was that the XIFIN system had played a vital role in increasing valuation as well as the due diligence process itself going smoothly.

"XIFIN allowed PML's CFO to provide Sonic with all of the reports and data that they needed, down to individual accounts if they so desired," said Skrisson.

"Our ability to recognize net revenue and maximize collections not only increased PML's valuation, but played a key role in our ability to attract an M & A suitor, get the best price and quickly navigate the process."

This provided Sonic with confidence that net collections, bad debt and other data were credible so that the process could quickly move forward. The ability to easily break things down to a client level and see the clients representing the top percentage of business allowed them to project post acquisition profits. "Our ability to recognize net revenue and maximize collections not only increased PML's valuation, but played a key role in our ability to attract an M & A suitor, get the best price and quickly navigate the process," said Skrisson.

http://www.darkdaily.com/sonic-healthcare's-latest-lab-buying-spree-nets-two-u-s-labs-for-20-million-813

http://www.sonichealthcare.com/media/53379/749568.pdf

CHAPTER FIVE:

CONCLUSIONS

The complexity of laboratory revenue cycle management is unmatched in all of healthcare.

By focusing on the billing, accounts receivable, and compliance processes, laboratory CEOs can increase the valuation of their business by recovering more revenue, without having to grow sales…

The complexity of laboratory revenue cycle management is unmatched in all of healthcare. The average lab's list of performed tests exceeds 2,000 and is constantly growing. Each of these tests brings its own coding and billing challenges. This is exacerbated by constantly changing requirements and rules for coverage and reimbursement by third party payers.

No one can say for certain how the healthcare landscape will continue to evolve over the next several years let alone the next decade. However, several things are certain. Insurance companies will continue to look for ways to cut costs, putting greater margin pressure on the lab market. As a result, the already small profit margins of some labs will evaporate with further contraction.

Volume will continue to go up, but economies of scale will be necessary to take the greatest advantage of this growth. Even the largest labs will see reductions in profit margins and a narrowing of the field of potential acquisitions. This means that labs of all sizes must find ways to maximize the returns of every claim.

By focusing on the billing, accounts receivable, and compliance processes, laboratory CEOs can increase the valuation of their business by recovering more revenue, without having to grow sales, as well as demonstrating the quality of their business to potential acquisition partners through detailed financial reporting and clean compliance.

...laboratory valuation is all about top line revenue, profitability, and minimizing risk. All of these important elements can be positively impacted by state of the art Revenue Cycle Management.

CEOs focused on non-organic growth of their laboratory can offset the normal post- acquisition revenue decline by accelerating the rate at which they realize synergies by employing comprehensive billing/AR systems to increase revenue and decrease IT infrastructure and maintenance costs.

At the end of the day, laboratory valuation is all about top line revenue, profitability, and minimizing risk. All of these important elements can be positively impacted by state of the art Revenue Cycle Management.

Appendices

A-2
Links to Billing/Coding/Collection Resources

(1) www.cms.hhs.gov/ClinicalLabFeeSched/

(2) www.futurelabmedicine.org/NationalStatusRptContent.aspx

(3) http://oig.hhs.gov/oei/reports/oei-05-99-00100.pdf

(4) The Pastin Report on Healthcare Compliance Programs
www.ethicsandcompliance.com/pastinreport.html

(5) Under Control: Sustaining Compliance with Sarbanes-Oxley in Year Two and Beyond
www.deloitte.com/us/undercontrol

A-3
About The Dark Intelligence Group, Inc. and THE DARK REPORT

The Dark Intelligence Group, Inc. is a unique intelligence service, dedicated to providing high-level business, management, and market trend analysis to laboratory CEOs, COOs, CFOs, pathologists and senior-level lab industry executives. Membership is highly-prized by the lab industry's leaders and early adopters. It allows them to share innovations and new knowledge in a confidential, non-competitive manner. This gives them first access to new knowledge, along with the expertise they can tap to keep their laboratory or pathology organization at the razor's edge of top performance.

It offers qualified lab executives, pathologists, and industry vendors a rich store of knowledge, expertise, and resources that are unavailable elsewhere. Since its founding in 1996, The Dark Intelligence Group and THE DARK REPORT have played in instrumental role in supporting the success of some of the nation's best-performing, most profitable laboratory organizations.

The Dark Intelligence Group (TDIG) is headquartered in Austin, Texas. This location makes it very accessible for any laboratory organization seeking input, insight, and support in developing their business operations, creating effective business strategies, and crafting effective sales and marketing programs that consistently generate new volumes of specimens and increasing new profits. The Dark Intelligence Group, Inc. owns and operates two Websites in the TDIG Website network:

http://www.DarkReport.com

http://www.DarkDaily.com

A-4
About XIFIN Inc.

XIFIN® delivers a powerful combination of technology and services enabling laboratories to optimize revenue cycle management while building value in their financial operations that enable diagnostic service providers to drive out costs while maximizing value. XIFIN develops financial management software that helps health care providers and laboratories automate their billing systems, manage medical claims filing, and reduce the costs associated with the complexity and regulatory compliance requirements of medical billing processes.

XIFIN offers a hybrid of traditional billing solutions that fills an important gap between on premise software and outsourcing options. It consists of a highly automated, web-based application with embedded infrastructure and managed services designed to support laboratory revenue cycle management. This integrated approach uniquely positions XIFIN to provide labs with the most sophisticated and up-to-date processing capabilities supporting their revenue cycle process.

http://www.xifin.com

www.darkdaily.com

www.darkreport.com

www.xifin.com