



HEALTHCARE IN DISTRESS: SIGNS THAT YOU MAY NEED TO RESTRUCTURE

INSIGHTS FROM THE BDO CENTER FOR HEALTHCARE EXCELLENCE & INNOVATION

While the initial tidal wave of COVID-19 has begun to recede, the effects of the pandemic are still rippling through the U.S. healthcare landscape. Initial CARES Act relief funds helped stave off financial instability for many facilities, but uncertainty over the potential of future relief, consumer confidence, lack of regulation surrounding telehealth reimbursement and market volatility continue to plague healthcare facilities financially.

As healthcare organizations focus on maintaining operations in the thick of the recession, they—and their creditors and bankers—should remain vigilant for signs of financial distress.

Generally, there are several signs of distress that span all industries, including:

- ▶ **Rising level of overall corporate debt** – Some companies will struggle to service or refinance this debt in the new economic climate.
- ▶ **Tight liquidity** – Includes insufficient cash on hand, inability to obtain new financing and inability to pay debts when due.
- ▶ **Fully drawn credit facilities** – Includes covenant violations that lower borrowing base availability, reliance on amendments or forbearances and deteriorating relationships with lenders.
- ▶ **Declining profitability** – Includes significant decreases in revenue, cash flow and EBITDA.
- ▶ **Debt in excess of the book value of assets** – Includes significant near-term debt maturities and solvency concerns.
- ▶ **Operational disruption** – Includes loss of key customers/vendors, increased Medicare pending and/or Medicaid pending balances, staff turnover and/or layoffs, service lapses.

As a result of the pandemic, some subsectors of the healthcare system have seen greater financial impacts than others. In particular, physician practices, hospitals and specialty surgery centers, diagnostic services and senior care facilities have faced significant headwinds. It is important for executives in these subsectors to understand potential signs of distress in their own organizations in order to adjust their operations or capital structures to maintain financial stability.



Physician Practices

- ▶ **Continuing low patient volume** – As COVID-19 continues, some patients are avoiding in-person visits due to safety concerns. While much better than in April 2020, patient volumes remain below historic levels which in turn is leading to significantly reduced physician compensation. This problem is heightened in practices that employ fee-for-service models.
- ▶ **Lack of capital access** – It remains unclear how access to the credit markets will be impacted which may place additional burden on physicians/practices that require access to capital to invest in key infrastructure, technology and talent.
- ▶ **High physician turnover rate** – Physicians seek stability in pay and work-life balance in the practice environment. It is anticipated this will lead to even greater consolidation as smaller practices seek greater levels of security. If these needs are not met at a physician practice, they will move elsewhere. High turnover among physicians in a practice means the practice is failing to provide the resources needed to succeed, pushing away the very drivers of success—the physicians themselves.
- ▶ **Complicated and unwieldy administration infrastructure** – Administrative functions, especially in the back office, can overwhelm resources when inefficient. Poorly-designed interfaces for EHRs can slow systems down, confusing diagnostic and treatment codes can impede the billing process and slow administrative processes can lead to delayed reimbursement claims. The more needlessly complicated the administrative process, the greater the threat.



Hospitals

- ▶ **Lack of affiliation with a healthcare system** – Smaller independent hospitals tend to have access to fewer resources, serve more uninsured patients and may have difficulty attracting top talent. Lack of affiliation or network can mean less flexibility to manage these risks.
- ▶ **Decline in emergency room, diagnostic and elective procedure patient volumes** – While fewer elective procedures were expected and occurred during COVID-19, the significant number of patients who decided to forego necessary medical ER intervention was not. Hospitals that continue to see lower patient volumes in the emergency room, and therefore subsequent lower new inpatient volume, will be subject to greater financial distress.
- ▶ **Extended staff cuts and furloughs** – Hospitals seeking to maintain liquidity during COVID-19 have furloughed some staff and instituted pay cuts for others. However, as they recover financially, these policies should reverse. If the policies continue for an extended duration, it's likely a sign that they have insufficient cash flow.
- ▶ **Supply shortages** – At the beginning of COVID-19, hospitals saw supply shortages (in particular, PPE) due to high influxes of COVID-19 patients and disrupted supply chains. Now, however, these challenges have abated and supply shortages should be resolved. If a hospital is still experiencing supply shortages, it may be because they don't have sufficient liquidity to purchase necessary supplies.
- ▶ **Increase in uninsured patients** – Many hospitals have seen an increase in uninsured patients who need COVID-19 testing or treatment. While the CARES Act includes reimbursement for these treatments, the reimbursement isn't always enough to cover the full costs. According to a [Fair Health report](#), the average charge per COVID-19 patient with no complications is \$42,486, whereas the average charge for a COVID-19 patient with complications is \$74,310. Potential Supreme Court rulings on the Affordable Care Act may also increase the number of uninsured patients in the years to come.



Senior Care Facilities

- ▶ **High incidence of COVID-19** – According to a [recent study](#), COVID-19 infections were more common in senior care facilities that a) had less liquidity; and b) had larger negative shocks to cash flow. As a result, COVID-19 outbreaks can indicate that a senior care facility is in financial distress.
- ▶ **Sharp drops in occupancy** – High entrance fees can deter new residents, and the pandemic may have pushed back move-in dates. Some people are also bringing their elderly relatives home for care due to fears that facilities are not safe from COVID-19 outbreaks. Occupancy in senior care centers has reached a 15-year low due to COVID-19, according to [Bloomberg Law](#). If facilities are not able to assuage consumer fears related to COVID-19 outbreaks, occupancy is unlikely to pick back up.
- ▶ **High staff turnover and a need for increased contract labor to meet staffing needs** – As nursing facilities have seen increased levels of infection and increased physician and mental strain experienced by nursing staff at SNFs, resulting turnover may require facilities to supplement staff levels in order to maintain standards of care. This additional cost of care may further strain already narrowing margins.
- ▶ **Reliance on outdated technology** – Technology adoption is crucial in senior care facilities, as evidenced by the widespread adoption of telehealth during the pandemic. Facilities that can't afford to invest in new technologies are likely in distress.
- ▶ **High reliance on Medicaid funding** – Facilities that rely on Medicaid could be in trouble due to a new rule proposed by CMS. The [Medicaid Fiscal Accountability Regulation \(MFAR\)](#) would restrict Medicaid supplemental payments for long-term care facilities, potentially leading to a \$50 billion cut in total annual funding. Facilities that are overly reliant on Medicaid may find themselves on the losing end of MFAR should it pass and should closely watch this issue.

Key Takeaways

- 1. COVID-19 has had an outsized impact on physician practices, hospitals and senior care facilities.** Executives and administrators at these organizations, as well as banks and other lenders that provide capital for these facilities, need to be aware of the unique signs of distress that each type of organization may exhibit both during and after COVID-19. Early detection of distress is key to avoiding restructuring or bankruptcy.
- 2. Declines in occupancy and patient volume are a continuing source of financial strain across all three organization types.** Hospitals and physician practices should focus on encouraging in-person visits by making patients feel safe with stringent safety and hygiene practices and protocols. Senior care facilities will need to adopt the strictest rules regarding safety, as COVID transmission among the elderly population is a particular concern.
- 3. Understand what problems your organization faces outside of the impact of COVID-19.** While the unique signs of distress in each organization have been exacerbated by COVID-19, not every sign of distress is rooted in the pandemic. Issues like unwieldy administrative structures, lack of affiliation with healthcare systems and high reliance on Medicaid funding will continue to impact hospitals even in a post-COVID world. Executives and administrators should begin considering what steps they can take to address these underlying issues today.

Maintaining operations throughout the disruption created by the pandemic requires an honest assessment of your organization's financial health. Signs of distress, when spotted early, can be the key to avoiding more serious financial woes down the line, including debt restructuring or even bankruptcy.

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Spot any of these signs in your organization? Get in touch.

STEVEN SHILL, CPA

Global and National Leader, Healthcare
714-668-7370 / sshill@bdo.com

PATRICK PILCH, CPA, MBA

National Leader & Senior Managing Director, Healthcare Advisory
212-885-8006 / ppilch@bdo.com

CORTNEY MARCIN, MPA

Managing Director, Healthcare Advisory
212-885-8242 / cmarcin@bdo.com

CHAD BESTE

Principal, Healthcare Advisory
847-410-5702 / cbeste@bdo.com

JIM LOUGHLIN

National Leader, Business Restructuring & Turnaround Services
917-414-1411 / jloughlin@bdo-ba.com

TOM WANG

Managing Director, Business Restructuring & Turnaround Services
646-729-4106 / tom.wang@bdo-ba.com

MICHELE MICHAELIS, CPA, CIRA, CTP, CFF

Managing Director, Business Restructuring Services
212-885-7281 / mmichaelis@bdo-ba.com

VIN PHAN, MACC

Partner, Healthcare Transaction Advisory Services
615-493-5613 / vphan@bdo.com

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