

# Sunset medical: outsourcing medical professional services essay sample

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Dr. Sally Jones, a practicing Orthopedic Surgeon, owns Sunset Medical, a professional corporation located in Colorado. Sunset is a small practice servicing patients from the local community and tourists who are in the region to frequent one of the area's ski slopes and hiking trails. Sunset is well respected by both Sally's peers and patients; Dr. Jones has been approached several times to move her practice to a large urban hospital where her practice could increase its \$1 million revenues several times over. However, Dr. Jones prefers the quiet lifestyle of rural Colorado to the more frenetic pace of urban living.

Sunset Medical experienced a great deal of turmoil over the past few years. In 2008, while at a medical convention, Medical Management Inc. (MMI) approached Dr. Jones with a proposal to provide managerial and billing services. MMI's pitch centered on utilizing synergistic core competencies, exploiting MMI's marketing and managerial expertise and Dr. Jones' professional reputation to increase revenues, decrease expenses, and improve cash flows. After lengthy negotiations, Dr. Jones signed a contract with MMI and after a three-month trial period, effectively turned over Sunset's day-to-day operations. However, at the end of the first full fiscal year, Dr. Jones finds herself questioning whether to continue Sunset's contract due to unforeseen financial setbacks or to terminate the contract and in-sourced all previously outsourced activities. Sunset Medical Pre-2009

Prior to contracting with MMI for managerial and billing services, Dr. Jones fostered a family atmosphere within the practice; many of the employees had been with the practice since its inception in 2000. This informal atmosphere facilitated a great deal of flexibility in employee roles, allowing

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Sunset Medical to function efficiently and effectively with minimal staff. In addition to Dr. Jones, Sunset Medical employed a support staff that included an office manager, billing secretary, nurse, and radiology technician. The office manager oversaw the practice's operations including scheduling patients, managing medical records, insuring compliance with various state and federal regulations, purchasing supplies, and managing the firm's finances. The billing secretary was responsible for taking coded medical records and preparing patient billing statements, and then maintaining contact with both the patient and their insurance provider to insure collection.

The nurse and radiology technician performed activities in direct support of the doctor, with the radiology technician also tasked with maintenance of the practice's x-ray machine and other equipment. In addition to her staff, Dr. Jones also retained Jackson and Associates, a local CPA firm, to provide financial statements and tax documents for the practice. Since Sunset is a relatively small, privately owned corporation, Jackson and Associates prepared a yearly Income Statement and Balance Sheet using a cash basis for accounting. To insure conservative estimates of income for tax purposes, revenues listed in the Income Statement were reduced by 100% of Accounts Receivable and the Allowance of Bad Debts was calculated at 100% of Accounts Receivable leaving net Accounts Receivable as \$0 in the Balance Sheet. Exhibits 1 and 2 shows the Income Statements and Balance Sheets provided by Jackson and Associates for the years ended 2006, 2007, and 2008. Similar to most professional corporations, Sunset's income statement shows very little Net Income in order to avoid double taxation.

Medical Management Inc.

In 2008, Dr. Jones was considering the purchase of a new X-ray machine due to technological advances in imaging, growth of her practice, and useful life of her current machine. While at a medical convention in New Orleans to investigate the purchase, Medical Management Inc. (MMI), approached Dr. Jones with a proposal to provide managerial and billing services to Sunset. MMI had grown rapidly over the preceding 5 years because of its ability to help doctors increase revenue through improved management and marketing of their practices while reducing costs by centralizing billing services. MMI's pitch appealed to Dr. Jones for two reasons. First, Dr. Jones had long recognized the importance of building Sunset's brand, but had neglected this aspect of business development because it was outside her area of expertise. Secondly, reducing the cost associated with administrative paperwork and billing could significantly improve net income.

A professional development seminar at the conference confirmed what Dr. Jones had already suspected, administrative paperwork and billing costs are a significant operating expense. According to industry data presented during the session, the average cost associated with these activities is between 4 and 9 percent of revenues, not including lost revenue from billing errors. To Dr. Jones, the opportunity to consolidate the costs associated with managerial and support functions with other providers while tapping resources Sunset did not currently have access to appeared to be a great way to grow Sunset Medical. Due to the potential positive impact on Sunset Medical from outsourcing administrative and billing services, Dr. Jones entered into negotiations with MMI. On April 3, 2009, Dr. Jones signed a

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contract with MMI effectively turning over day-to-day operations of Sunset Medical to MMI. Exhibits 3 and 4 contain excerpts from the contract between Sunset Medical and MMI include the scope of the engagement, party responsibility, and compensation of MMI.

Under the initial contract, MMI agreed to a three month probationary period where they would serve as the manager of the practice and assist the Business Office Manager in the day-to-day operations. Specifically, MMI was responsible for marketing, public relations, staffing, and the administration of the company's corporate compliance plan as well as for providing unaudited financial statements. To compensate MMI, Sunset agreed to pay a monthly management fee equal to four percent of monthly net revenue, determined on the accrual basis. Net revenue was determined based on gross billed revenue less contractual allowances and a reasonable allowance for uncollectable accounts. Additionally, Sunset agreed to pay a billing and collection fee equal to five percent of company's monthly net receivables. At the end of the three month probationary period, either party could opt out of the contract, the terms of the contract could be extended, or Sunset could turn over full management control to MMI. Medical Management Inc. – Three-Month Performance Review

MMI assumed administration of Sunset in April of 2009 and began making incremental changes to the practice. Under MMI's management, a series of marketing initiatives were undertaken that substantially increased Sunset's brand recognition. To improve the practice's imaging capabilities, Sunset borrowed \$100, 000. 00 and used the note and cash on hand to purchase a

new X-Ray machine at a cost \$171, 145. 29. Additionally, to reduce the costs associated with an independent accounting firm, Jackson and Associates were taken off retainer and MMI utilized internal accountants for reconciling Sunset's books. At the end of the first three months of MMI's management and in accordance with the contract, MMI provided Dr. Jones with an Income Statement, Balance Sheet, and Statement of Cash flows for the six months ended June 30, 2009. Utilizing internal accountants to prepare the financial statements, MMI cited internal policies in changing the reporting basis of Accounts Receivable in the financial statements, choosing not to reduce revenues by Accounts Receivable and calculating the Allowance for Bad Debts as 0% of Accounts Receivable.

Citing the increased revenues and cash flows, MMI asked Dr. Jones for more control of the company, including power to recruit, hire, terminate and supervise all employees, including the Business Office Manager. Dr. Jones granted the additional power and MMI immediately terminated the contracts of both the office manager and the billing secretary. A new Business Office Manager was subsequently identified and hired by MMI. At the beginning of 2010, MMI released the 2009 financial statements of Sunset Medical to Dr. Jones. The financial statements indicated that under the MMI management, Sunset increased revenues from \$1, 167, 041. 88 in 2008 to \$1, 601, 050. 52 in 2009. However, despite earning more than \$400, 000 in additional revenue, Sunset's cash had fallen dramatically during the year. In fact, Dr. Jones had borrowed \$200, 000 during 2009 including \$100, 000 used in the purchase of the X-Ray machine. Exhibits 5, 6, and 7 show both the mid-year

and year ended December 31, 2009 Income Statement, Balance Sheet, and Statement of Cash Flows as released by MMI. Sunset Medical: 2010

Upon receiving Sunset's financial statements from MMI in January of 2010, Dr. Jones began analyzing Sunset's business practices to determine why the company was required to borrow a significant amount of money to maintain a positive cash flow. While the X-Ray machine had cost in excess of \$175, 000, Dr. Jones was at a loss to explain the need to borrow \$200, 000, especially in light of an additional \$400, 000 in revenue. As Dr. Jones poured over the prior years financial statements prepared by MMI and previously by Jackson and Associates, she began to question whether the financial statements provided by Jackson and Associates for 2006, 2007, and 2008 were comparable to the financial statements prepared by MMI in 2009.

This caused her to question whether actual revenues had increased by over \$400, 000 in 2009 and whether MMI was working in the best interest of Sunset Medical, P. C. To satisfy her curiosity, Dr. Jones commissioned Jackson and Associates to perform an audit of Sunset's books. In performance of their duties, Jackson and Associates compiled reconciled the financial statements for Dr. Jones to review as displayed as Exhibit 8, 9, and 10. Dr. Jones would now like you to review the practice's situation to determine the circumstances that created the unforeseen financial setback and provide feedback on whether she should terminate MMI's contract or continue on the practice's current path. Requirements and Discussion

Based on the financial performance reported by MMI and Jackson and Associates, write a brief report detailing important aspects of the current

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situation, identifying the underlying cause of the unexpected financial setback, and make a recommendation to Dr. Jones about continuing/terminating MMI's contract.

[ 2 ]. While this case uses actual data from an actual Orthopedic practice, all names have been changed and any resemblance to actual persons or companies is purely coincidental.