Lakelet Advisory Group LLC
Focusing on Business Results
NEWSLETTER
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The Distressed Skilled Nursing Facility:
From Disaster to Turnaround

The health care industry is composed of numerous sectors, including hospitals, assisted-living facilities, home health agencies and skilled nursing facilities. As a whole, this industry is not immune to the challenges facing nearly every sector of the economy. In fact, the health care industry may face bigger challenges than other industries: extensive state and federal regulations, stiff competition, ever changing laws and a relative scarcity of capital. Last but not least, the health care industry is highly dependent upon government funding through Medicare and Medicaid. This is a capricious source of revenue that may have serious timing issues, fluctuate according to political whims or may not adequately address the costs associated with service.

When facing distress, every segment of this industry requires a special blend of management skill and turnaround acumen.

The SNF Business Model

A skilled nursing facility (SNF) bears a special social responsibility: it cares for our society's ill and aged — a segment that has diminished capacity as a social or political voice.

A complex regulatory and legislative environment reflects this responsibility, making compliance a major challenge for the SNF. Coping with laws, rules and changes to them requires an extraordinary effort, as do the fierce competitive environment and the constant quest to keep beds full.

A SNF not only houses and feeds its residents, it actually provides the same services as a hospital, except surgery. This means that it is very labor-intensive and requires a broad range of functions and skills from its staff. Staff roles may range from simple tasks to duties that require a high level of skill, training and education. This business model also operates on a 24/7 basis. These characteristics create a special difficulty in recruitment, retention and training. A union environment may very well present additional challenges to management. An SNF must also face the caprice of Medicaid and Medicare compensation.

Should it encounter financial difficulties, it will have fewer options in terms of capital providers. If financial difficulty is acute and Chapter 11 is necessary, the process is exceptionally onerous due to the regulatory environment.

Turnaround Denied

Most organizations move along a continuum of diametrical opposites that reflect very different internal states of affairs. At one end is the custodial environment, reflecting a relatively healthy or robust organization. At the other is distress or crisis.

The turnaround is a metamorphosis that is tragically delayed and may require a wrenching and intense period of change. A useful definition of it appears in *The Turnaround Experience* by Frederick M. Zimmerman, including three parameters required for measuring turnaround success:

1. Profitability improves for at least several years after the crisis.
2. Profitability is positive.
3. Market position significantly strengthens, either by increasing market share or by successfully concentrating on an important subset of the market.

Turnaround may be thought of as operational, strategic, financial, statutory (Chapter 11) or non statutory (a reorganization of debt outside of Chapter 11). These categories are not really standardized or even widely accepted. For the purposes of the SNF paradigm, we examine the turnaround from the perspective of financial, operational and debt restructuring.

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The Assignment: a Catastrophe

Our team was brought in to reverse the fortunes of a 400-bed group of nursing homes. This family-owned enterprise had been neglected for years. Symptoms of this neglect were profound and included:

- A serious and immediate cash crisis. The company could not meet weekly payroll.
- Over 40 cases of litigation from unsecured creditors.
- Poor relations with the secured creditor; a formal demand was a real possibility.
- Grievous quality of care. The Department of Health (DOH) was considering cancelling operating licenses and had imposed a Denial of Payment for new admissions Accordingly, the census declined precipitously.
- Poor financial record-keeping due to the burdens of distress placed upon custodial management. Even basic financial reports, such as monthly profit and loss, no longer existed.
- Huge losses on operations relative to sales. Operating losses exceeded 25% of gross revenue.
- Billing at least 25% below what it should be.
- Very poor employee morale; for some categories, turnover exceeded 100%.

This group was at the far end of the custodial-crisis continuum, it was very nearly moribund.

Financial

It is not uncommon when facilities are in a late stage of decline for accounting/management information systems (MIS) to be affected. Human factors further impair the organizations ability to deliver useful information. Denial is often pervasive, and the result is a paucity of critical thinking and reluctance to be the harbinger of bad news. In this environment, information systems often produce data that is late, erroneous and insufficient — a very common characteristic of the distressed organization. At the subject SNF, even basic monthly financial statements were not available.

Unfortunately, the tools for planning, control and prosperity are at the nexus of the accounting/MIS function. And this begins with the delivery of financial information that is relevant, reliable and timely. The challenge is restoring or rebuilding accounting/MIS while making critical management decisions. Our distressed SNF illustrated some key considerations:

- The first principle of this exercise is derived from the most dominant characteristic of the distressed organization: Data is usually erroneous or incomplete.
- The first tactical move is to conserve and control cash while seeking new sources. Cash helps manage threats.
- Time is everything, and there will not be enough of it. Dalliance and dithering will result in failure.
- Emphasize management accounting. Correcting historical data, making fine adjustments to the GL and ruminating over tax matters are irrelevant.
- A turnaround plan requires an understanding of current performance, an accurate balance sheet and projections for the next two or three years. These will integrate the income statement, cash flow statement and balance sheet and will include anticipated debt reductions.
- While this process is occurring, fix accounting/MIS. Pay particular attention to systemic and procedural issues that provide a solid platform for the timely delivery of information that is both relevant and reliable.

Operations

Together, the MIS and accounting system will provide timely and accurate information that will be leveraged and applied in a culture of performance management (PM). The key principles are competent leadership, accountability for all and capability.

Managers must implement PM with a clearly articulated strategy that requires identifying core drivers; setting attainable, measurable targets; and review and correction. Symptoms that indicate a lack of PM include:

1. A lack of rigor surrounding cash management.
2. Poor or even nonexistent controls for manufacturing, planning and procurement.
3. A disconnect between financial measurements and key performance drivers.
4. A lack of accountability within management ranks.

For the distressed SNF, it is important to remember the following:

- Billing in the SNF is very different from other industries. Hard won earnings due from a robust census can be lost or reduced through neglect or inaccuracy, especially for Medicaid and Medicare reimbursement. This requires maintaining accurate and fully developed charts.

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- Revenue enhancement is more than simply trying to increase prices. Opportunities might be found in changing a facility's patient mix to include more private-pay patients, more Medicaid patients or more patients requiring services that offer higher reimbursement rates.
- Once identified, SNFs can only realize opportunities with aggressive and targeted marketing plans. Ultimately, however, success is the quality of care.

Debt Restructuring

The most common form of debt restructuring is a Chapter 11 proceeding under the United States Bankruptcy Code. Because is a procedure under law, it is statutory restructuring. It is also possible to restructure debt informally (non statutory restructuring). In both cases, debt restructuring means reducing debt or changing the terms for the benefit of the creditor.

Of course, the idea is to improve both the balance sheet and break-even position of the business. Thus, debtors usually will accept a restructuring only if it is a better option than selling or liquidating the firm. Borrowers can structure informal settlements quickly and at relatively little cost, but they do not provide any protection from creditors or other threats. The Chapter 11 proceeding, on the other hand, provides protection and a legal venue for debt reduction. Chapter 11 is litigious by nature and therefore expensive, however, and also contains the implicit possibility of bankruptcy (liquidation). The potential benefits to a creditor are therefore huge.

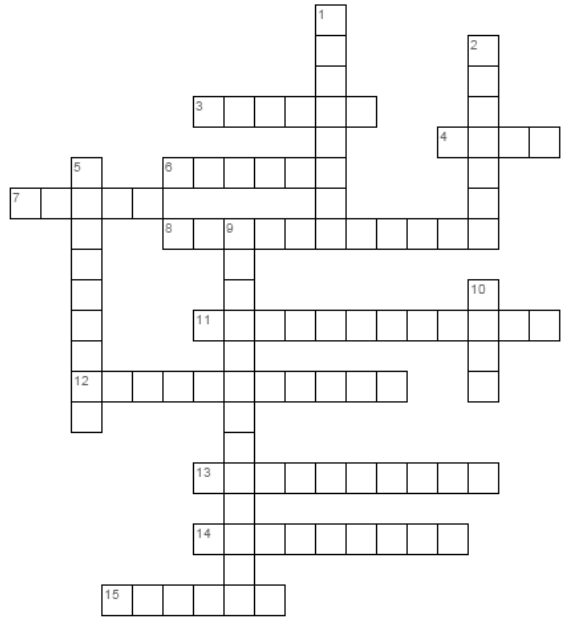
Statutory and non statutory bankruptcies are double-edged swords. Companies should not choose either course without careful forethought and expert advice. Most important, protection from creditors and debt rationalization are not magic bullets. They must always be integrated into a viable plan that includes both an operational and financial turnaround strategies. In such a context, a new business can often emerge from the ashes.

The Turnaround Complete

In fact, that was case with our SNF assignment. After about ten months and a successful Chapter 11 filing, a new business emerged. Profitability improved (it was also positive), and both market position (the quality of care) and market share improved. A reconstructed accounting/MIS synthesis supported all of this, improved operations and created a culture of performance management. The SNF is still in business today.

Test your Business Knowledge

Answers will be provided on LakeletFG.com



ACROSS

3. The most effective step to detect and prevent collusion is segregation of ___.
4. When it comes to corporate turnarounds, ___ is of the essence.
6. Protect your organization from fraud by promoting strong ___ throughout the organization.
7. Every organization should have a written policy regarding ___.
8. ___ crime is significantly on the rise and is becoming increasingly difficult to identify and effectively respond to.
11. The process of comparing one's organizational processes and performance metrics to industry bests or best practices from other industries.
12. The most expensive cost of a turnaround is the ___ costs.
13. CPAs only identify about 3% of instances of fraud during audits, while ___ finds 6% of frauds by accident.
14. Financial forensic professionals perform ___ investigations, provide analysis, support litigation and / or prosecution, and report their findings to the counsel, company officers and / or the board.
15. Failure to ___ is one of the many reasons turnarounds fail.

DOWN

1. To deal with fraud, you need a professional financial ___ fraud examiner.
2. The roles of a "value-added" CFO include: Expand leadership skills and increase capacity as a trusted ___.
5. In cases of business interruption, a ___expert will estimate lost profits caused by fire, flood, or other unforeseen events, as well as project the economic loss caused by an injury or wrongful death.
9. Financial Forensics is often referred to as "the art and science of ___ people and money.
10. The percentage of revenue a typical organization loses to fraud each year.

Lakelet Advisory Group LLC
50 Fountain Plaza, Suite 1400
Buffalo, NY 14202

Strive not to be a success,
but rather to be of value.
- Albert Einstein

Our greatest weakness lies in giving up.
The most certain way to succeed
is always to try just one more time.
-Thomas A. Edison

What's Happening With Lakelet This Quarter?

- Effective January 1, 2016, LAG will be launching its healthcare business group. As rapidly as the healthcare industry is growing in the United States – directly correlated to this astronomical increase are the challenges of healthcare turnarounds and fraud. Few health care leaders would disagree that the U.S. health care industry needs to drastically change. The processes, regulations and objectives are so complex that the typical business model is not sufficient or appropriate. Next to the industrial sector, healthcare is the second highest industry requiring turnaround expertise. Today, as with other industries, the healthcare industry needs to take aggressive actions to change its business models and practices.
- On December 2nd, 2015 Tim Crino spoke at SUNY Fredonia's Accounting Society and discussed careers in Forensic Accounting.
- On December 8th, 2015 Michael Koeppel was a speaker at the NYS Society of CPAs on the topic of Fraud in Bankruptcies and Distressed Entities.

Top 8 Most Distressed Industries Predicted for 2015-2020

1. DVD, Game & Video Rental
2. Solar Panel Manufacturing
3. Apparel Knitting Mills
4. Recordable Media Manufacturing
5. Photofinishing
6. Mail Order
7. Computer Peripheral Manufacturing
8. Database and Directory Publishing