The Financial Situation of MHA Regulated Providers of Community Mental Health Services: Fiscal Years 1999 through 2008

August 31, 2010

Prepared for: Mental Hygiene Administration

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Note: This report was prepared prior to the passage SB633, and does not include the "market-basket" report required by the legislation. Additional information will be released late fall 2010.

The Financial Situation of Providers of Community Mental Health Services to the Public Mental Health System, Fiscal Years 1999 through 2008

Executive Summary

This report is based on data extracted from financial reports submitted by 106 providers. This is a much larger number of providers than has been available in prior years, so the changes reported between 2007 and 2008 may not be meaningful.

The financial condition of the providers of community mental health services to the Public Mental Health System generally deteriorated from 2005 to 2006, recovered a little to 2007, but deteriorated again from 2007 to 2008, with a drop in the median margin to 1.5% and with 33% of reporting providers losing money in 2008.

Bad debts represent 1.4% of total expenses (see Section 4.5).

Providers had, on average, 38 days of revenue in Receivables. Cash and investments were 8% of total expenses (see Section 4.3).

1. Introduction

The analysis reported here examines the financial status of the mental health providers of community services and show trends for the fiscal years 1999 through 2008.

A number of caveats need to be made to avoid reading too much into this data. The first is that there is no single financial measure that gives a complete picture of the financial situation of a provider. Therefore, it is necessary to examine several indicators to obtain an overall picture. A second is that the expenses and payments are not just those associated with services paid for by the state, so this is not simply an analysis of the impact of the MHA payment system. Another caveat is that the set of providers reporting is not the same in each year. In particular, the number of providers included for 2008 was much larger than the number included in prior years.

2. Data sources

The data used for this analysis were extracted from the fiscal year 1999 through 2008 Audited Financial Reports. Up through 2006 these reports were all provided by the Community Behavioral Health Association of Maryland (CBH). For 2007 and 2008 reports were received from CBH and also from providers through MHA. The following table shows the number of audited financial reports that were used for the analysis in each year. It should be noted that in prior years these represent a small proportion of the total number of providers, but a substantial proportion of the total revenue of the mental health system, since the providers included in the analysis tended to be the larger ones.

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
No. of reports	19	48	47	33	30	31	34	32	48	106

The following data fields were extracted from the fiscal year 2008 Financial Reports (definitions of the terms is included in Attachment 1) where they were available, but for 28 providers only the revenues and expenses were available.

- Total expenses
- Total revenues
- Current assets
- Total assets
- Current liabilities
- Long term liabilities
- Total liabilities
- Contributions
- Cash and investments
- Receivables
- Bad debts

3. Financial ratios calculated

The accounting profession has traditionally used various financial ratios to measure the financial condition and performance of organizations. Following this approach, this report has used the data available from Audited Financial Reports to construct financial ratios for use in evaluating the financial condition of the providers.

The data were used to calculate seven financial ratios or indicators several of which are generally considered to be indicative of the financial health of a provider. These were:

Profit margin:	(Total revenues - Total expenses)/Total revenues
Current ratio:	Current assets/Current liabilities
Net assets:	Total assets - Total liabilities
Days in receivables:	(Receivables/revenues) x 365
Days of cash:	(Cash/expenses) x 365
Bad debts	Bad debt expenses/Total expenses
Contributions	Contributions/Total revenue

Most providers are on the accrual basis of accounting for their financial records, which recognizes revenues and expenses as they occur throughout the reporting period. The profit margin shows the relationship between revenues and expenses, and is probably the most important financial ratio. A positive profit margin is desirable.

4. Results

4.1 Profit Margin

The term "profit margin" is used as it is generally understood. However, it should be noted that while most of the providers are what are often described as "not-for-profit" organizations, all organizations require some level of profit in order to sustain their existence and build up funds to replace their buildings and equipment – a better terminology might be that these are tax-exempt organizations. In addition, the revenues reported by some providers included grants that were used to pay for capital acquisitions rather than for operating expenses.

The margin (profit margin) is probably the most important indicator of the financial health of an industry (and an individual company), as it shows whether the industry is covering its costs and has the capacity to accumulate reserves for future investment. The mean margin of the providers of community services and the spread of the margins are shown in Table 1.

Table 1: Profit Margins	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Highest	14.3%	34%	26.7%	24.2%	20.4%	28.1%	15.0%	24.8%	26.1%	81%
Median	3.2%	4.5%	4.5%	1.1%	2.5%	2.0%	2.5%	1.4%	2.5%	1.5%
Lowest	-11.4%	-5.0%	-8.1%	-9.1%	-8.3%	-14.8%	-11.9%	-20.0%	-18.7%	-57% [1]
Mean (wgtd)	5.3%	6.0%	5.2%	2.3%	2.9%	2.1%	2.6%	5.4% [2]	3.5% [3]	1.9%

Of the providers of community services included in this analysis for FY 200835 of the 106 had negative margins (i.e., 33%). Chart 1 shows that the losses tend to be concentrated in the smaller providers, although a couple of larger providers had substantial losses in 2008.

For comparison purposes, a similar analysis of providers contracting with DDA for FY 2007 showed a median margin of 1.6% and a weighted mean margin of 1.0%. The Health Services Cost Review Commission in their Financial Disclosure Report dated July 1, 2009 reported that Maryland hospital operating profits from regulated and unregulated activities were 3% for fiscal year 2007 and 2.3% for fiscal year 2008.

The providers were classified into revenue quartiles, i.e., the quarter with the lowest revenue, the quarter with the highest revenue, and the two middle quarters. These quartiles were roughly:

1 – Revenue up to $700,000
2 – Revenue between $700,000 and $1,900,000

[1] Excluding one small provider with expenses more than twice their revenue.
[2] The mean in 2006 was heavily influenced by 2 large providers with substantial margins.
[3] The weighted mean margin would be lower if 2 outliers in terms of margin were to be removed from the data.

3 – Revenue between $1,900,000 and $5,000,000
4 – Revenue over $5,000,000

Summary of Profit Margin by Revenue quartile

Revenue range	# providers	Median margin	Lowest margin	Highest margin
< $700,000	28	6.6%	-123%	59%
$700,000-$1.9M	25	2.1%	-22%	81%
$1.9M-$5M	27	-1.7%	-11%	13%
> $5M	26	1.8%	-57%	15%
State	106	1.6%	-123%	81%

4.2 Current ratio

The current ratio is an indication of how much cash and other liquid assets (receivables and marketable securities) a provider has available, as compared with their current liabilities. It is an indicator of whether the provider has funds to pay its bills on time. Generally, the higher the ratio, the better the situation of the provider. The spread of the current ratio is shown in Table 2.

Table 2: Current ratio	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Highest	8.5	37	35	11	13	17.6	20	38	39	54
Median	1.6	2.0	2.4	2.1	2.1	2.8	2.6	2.7	2.5	1.9
Lowest	0.6	0.01	0.04	0.3	0.4	0.6	0.5	0.6	0.2	0.2

4.3 Cash and investments and receivables

Cash and investments represent money that is available to the provider in the short term. Cash and investments were 12% of the total expenses. The cash available, thus, represents 43 days of expenses. Some of this cash may be restricted or allocated for specific capital projects and so may not be available for operations. Revenue from investments is often an important source of revenue for the providers, and this can fluctuate from year to year, with changes in the stock market and interest rates.

Table 3 shows the percentage that cash and investments comprise of total expenses in recent years:

Table 3: Cash & investments	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Percent of expenses	7%	9%	7%	12%	25%	19%	17%	22%	22%	8.4%

While this table suggests a substantial improvement in the cash position of the providers in FY 2006, holding steady to 2007,but deteriorating in 2008 it should be interpreted cautiously. The set of providers included in the analysis changes between years, and some of the reports do not allow for the identification of cash and investments.

Receivables comprised 10.4% of the total revenues, so providers had, on average, 38 days of revenue in receivables.

4.4 Net assets

Of the community service providers included in the analyses, 3 had negative net assets in FY 1999, 5 had negative net assets in FY 2000, 2 had negative net assets in FY 2001, 2 had negative assets in FY 2002, 1 had negative net assets in 2003, 1 in 2004, 1 in 2005, none in 2006, 1 in 2007, and 8 in 2008.

4.5 Bad debts

Bad debts are not reported uniformly by the providers in their audited financial reports, and sometimes not reported at all, so the figures presented here are almost certainly underestimates of the amount of bad debts experienced. However, they are indicative of the order of magnitude of the bad debts, and the trends over time.

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bad debt %	1.3%	1.2%	2.0%	2.4%	1.8%	3.0%	3.4%	1.7%	2.4%	1.4%

4.6 Contributions

Contributions were 2.2% of the revenues of the providers.

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
%	1.9%	1.5%	1.8%	2.0%	0.6%	0.8%	0.8%	1.5%	3.9%	2.2%

Many providers did not separately identify contributions, or had no contributions. It was not possibly to separate these two circumstances.

5 Summary

The percentage of providers with negative margins increased from 2007 to 2008, and the margins declined. There was a general deterioration in the financial condition of the providers included in this study from 2007 to 2008.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
% with negative margins	16%	21%	17%	33%	30%	35%	26%	31%	24%	33%
Number with negative net assets	3	5	2	2	1	1	1	0	1	8
% with current ratio < 1	21%	17%	13%	22%	18%	11%	19%	6%	15%	23%

Attachment 1: Definitions of terms

Total expenses: The total costs incurred by the provider during the year. These costs include labor, supplies, maintenance, contracts, depreciation of buildings and equipment.

Total revenues: The total payments received by the provider. These include payments from the state, payments from other payers, interest and investment income, donations.

Current assets: Assets that are available in the short term. These include cash, receivables, and marketable securities.

Total assets: All assets including the current assets, and long term assets such as buildings and equipment (after taking out accumulated depreciation).

Current liabilities: Payment due from the provider in the near future. These include payables and current mortgage payments.

Long term liabilities: Amounts due in the long term. These generally include mortgage payments (beyond the present year's portion) and other long term debt.

Total liabilities: The sum of the current and the long term liabilities.

Bad debts: Bad debts are the costs associated with services provided to clients in the expectation of payment, but for which payment was not received. Bad debts do not include contractual allowances to third party payers, but do include the costs of unpaid copayments or deductibles.

Chart 1: Scatter plot of margin versus revenue

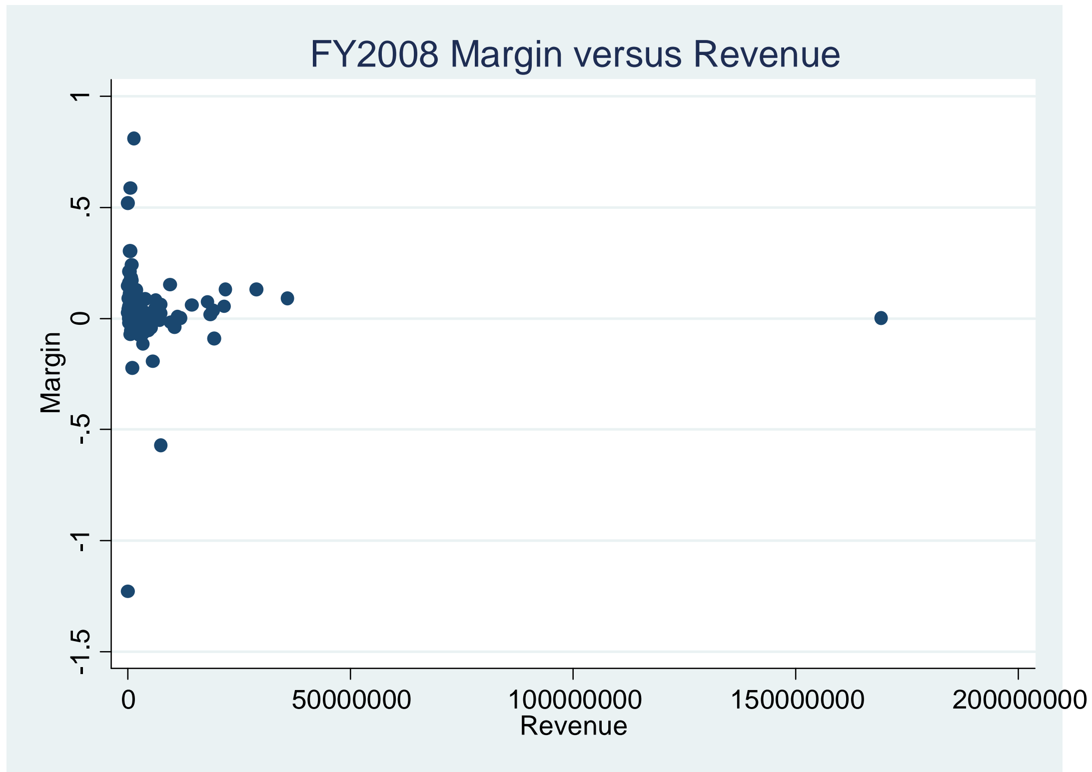
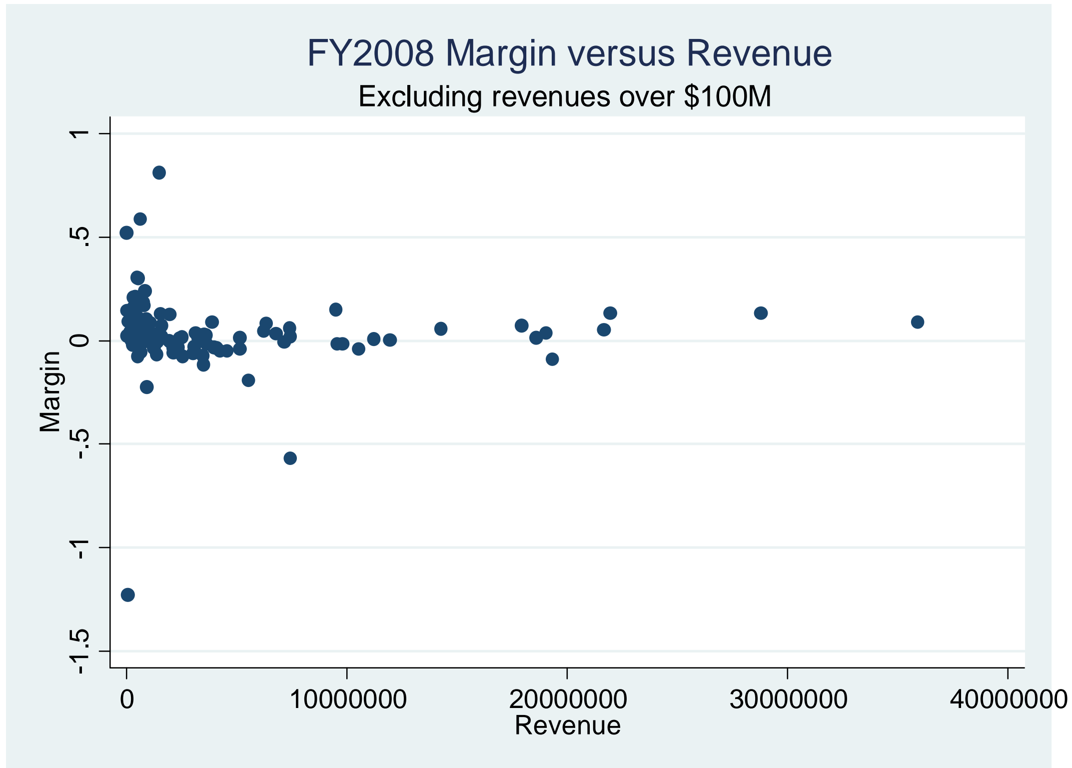


Chart 2: Scatter Plot of Margin versus revenue excluding outlier



This chart illustrates that the smaller providers tend to have the largest spread in their margins.

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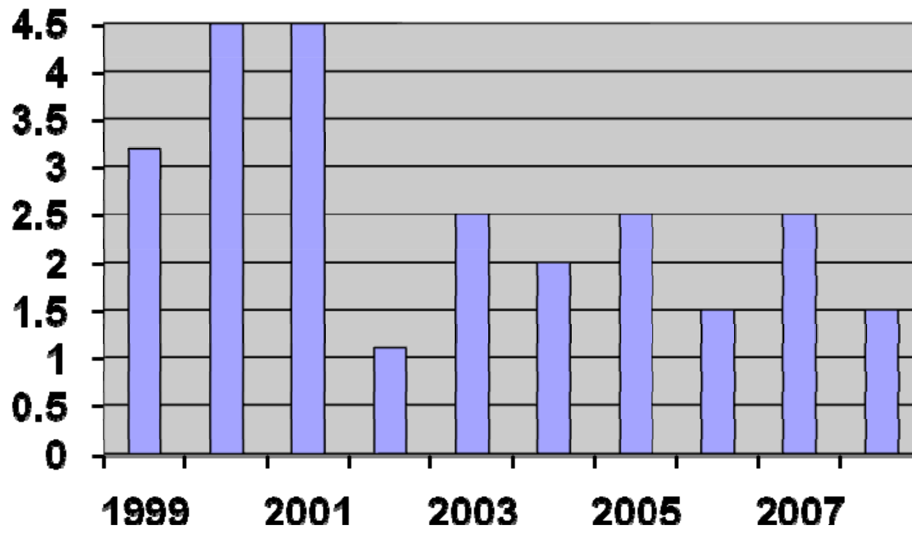
Median margin



% with negative margins