

1997 – 2002 - HMO Failures

This study of HMO failures over the last five years should prove valuable to any practitioner that has clients in these areas. These statistics and the commentary that attaches to them may provide some insight into risk areas not previously considered. It goes without saying that we learn most from our failures and much can be learned from the failures of the companies in these industries. This section should be read in conjunction with our analysis of life and health insurance failures. Taken together they paint a picture of material losses for all health related industries in 1999 and 2000.

Failures and the Practitioner

It is well known that when a company fails, goes into bankruptcy or is taken over by a regulator, one of the duties of the trustee or receiver is to determine whether there is a third party that is culpable for the company's demise. We at AccountingMalpractice.com monitor company failures for several reasons, three of which are:

1. To keep the practitioner abreast of trends in a particular industry;
2. To identify any malpractice suits that have arisen; and
3. Identify the root causes of the claimed malpractice.

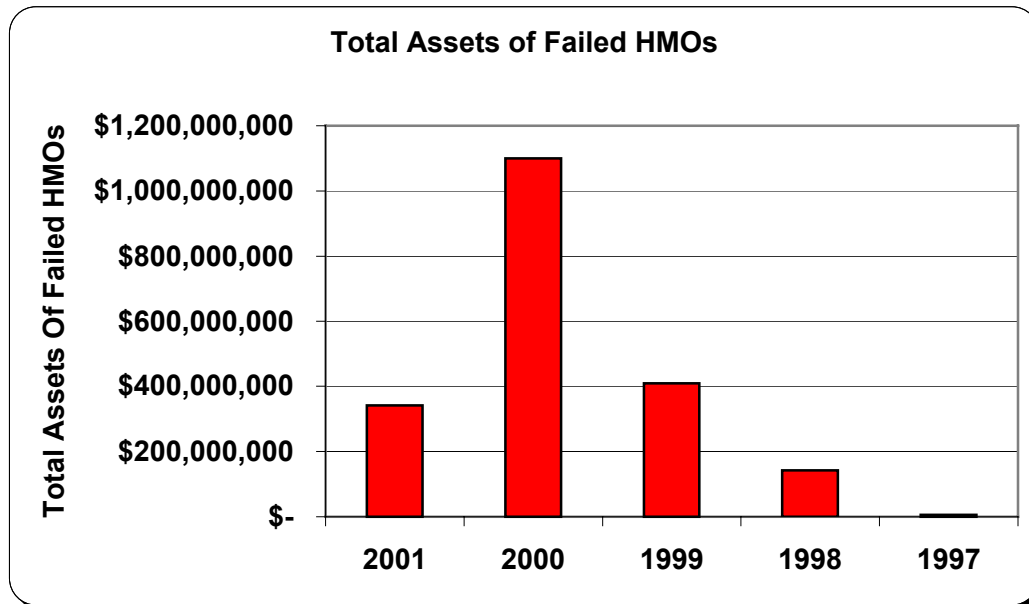
HMO Failures:

Even though the highest number of HMO failures occurred during 1999, 2000 represents some of the largest failures and can be considered an anomalous year. In fact, the assets of only two failed HMO's in 2000 equaled 78% of the total assets of failed HMOs in that year. Further, after adjusting for the anomaly the average combined assets of the failed HMOs (1997-2001) was approximately \$28 million. Many of these failures appear to be the result of industry consolidation activities pushed by record losses. Many of these losses appear to have been triggered by aggressive competition among these insurers.

While, the number of HMO failures appears to be forming a downward trend, the average size of the HMOs is increasing. In this respect, the failure of one HMO client may prove more problematic than several small organizations. This trend will also be challenged by changes in Medicare and Medicaid rates, higher prescription drug rates, life-extending

technologies, mix of services, efficiencies, demographics, cost sharing provisions, number of covered services, aging population, legislative and regulatory mandates, etc.

Graph 2



Malpractice Claims

A random selection was made to determine if the outside auditors were sued as a result of a HMO's failure. We noted one particular case where an international accounting firm settled with the state's Department of Insurance for nine million dollars. The case involved Medicare and Medicaid fraud. For other cases and insights into specific failures see our case search in www.AccountingMalpractice.com. You may also want to check our case document database. That database has approximately 14 cases associated with HMOs.

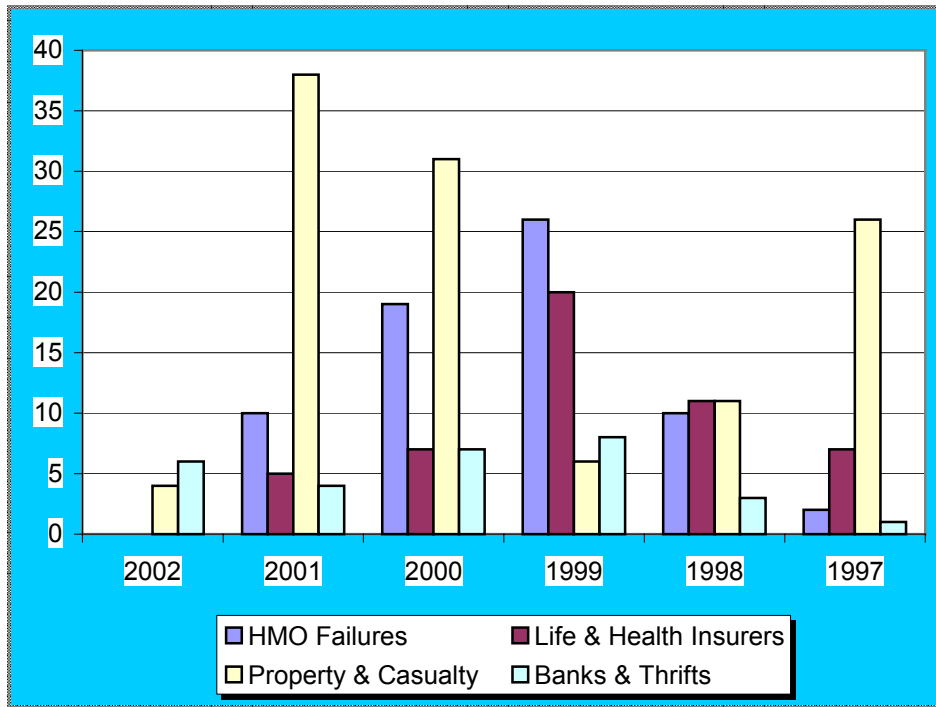
In many of the cases of HMO failures, the issue was about either pricing or contractual commitments. In many cases these HMOs, facing stiff competitive pressures, entered into marketplaces or contracts that proved distinctly unprofitable. In some cases, the bankruptcy filings were used as a vehicle to get out of these onerous contracts. New price increases seem to have steadied the industry, but many of these did not come about until many of the HMOs were already in trouble, some beyond repair.

One of the more significant risks in the HMO industry arises from the fact that a troubled business does not have to be insolvent prior to a regulator taking it over. And when a regulator or receiver takes it over, they may make things even worse. In such a circumstance, inevitably, someone will need to be blamed. If the problem is financial in nature and an auditor had failed to alert an "unsophisticated" director of pending

problems, then they can expect to become a scapegoat. Consider that when it comes to HMOs, it is often the Attorney General that acts as the receiver. Since a great many people rely on HMOs, you as the “public watchdog” may be an ideal target.

Other Comparison Information

Graph 1 – Number of failures by Industry type – for general information purposes



The above chart was provided for scale purposes. It identifies the relative number of failures within in of these services areas.