


# Essentials of Hospital Finance

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# Today's Goals

- Help you understand what to look for in your hospital's financial statements
- Help you better understand how you get paid by Medicare, Medicaid and others
- Help you understand some current key trends

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# Health Care Finance Challenges

- Health care finances are certainly different than many industries
  - ❖ What other industry willingly accepts 20 to 30% of a bill...and is happy?
- Some unique aspects of health care finance
  - ❖ Highly regulated by government
  - ❖ Very capital intensive
  - ❖ Low margins
  - ❖ Challenge to balance community benefits with need to remain financially viable

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### Should a Hospital (even a Hospital District) Make a Profit?

- Of course – but why?
  - ❖ Equipment and expansion
  - ❖ Physician recruitment needs
  - ❖ Special circumstances requiring large cash outlays
- How much profit is enough?
  - ❖ Key rating agencies (S&P, Moody's) report average operating margins of 1.5% to 3.0%
  - ❖ Total margin (which includes investment income) should ideally be about 1% higher than the operating margin
- Did you know...
  - ❖ In many years, more than 50% of hospitals lose money from operations

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### Net Patient Service Revenue

- Gross Charges
  - ❖ The "full" charge of a provider
  - ❖ Based on data in the Charge Description Master (CDM)
- Contractual Adjustments
  - ❖ The difference in the Gross Charge and the amount a provider has contractually agreed to accept
  - ❖ Providers cannot attempt to collect this difference
  - ❖ Most often associated with Medicare, Medicaid and managed care/commercial insurance payers
- Bad Debts and Charity
  - ❖ Amounts that a provider is allowed to collect but cannot or does not
  - ❖ Charity is usually based on documented indigent status and has little to no collection effort
  - ❖ Bad debts occur after substantial collection effort

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### Medicare Payment Methods

- Prospective Payment System- Acute Care Hospital
  - ❖ Predetermined payments based on patient acuity or groups of services provided- DRG for Hospital IP and APC for Hospital OP
  - ❖ Most common payment method for providers like hospitals, nursing homes and home health agencies
- Cost based reimbursement- Critical Access Hospital
  - ❖ Payment based on Medicare's share of cost of providing care
  - ❖ Medicare only pays for allowable costs
  - ❖ Mostly limited to rural facilities
- Fee schedule
  - ❖ Much like prospective payment, but based on individual non-packaged services
  - ❖ Covers most physician, therapist and mid-level provider payments

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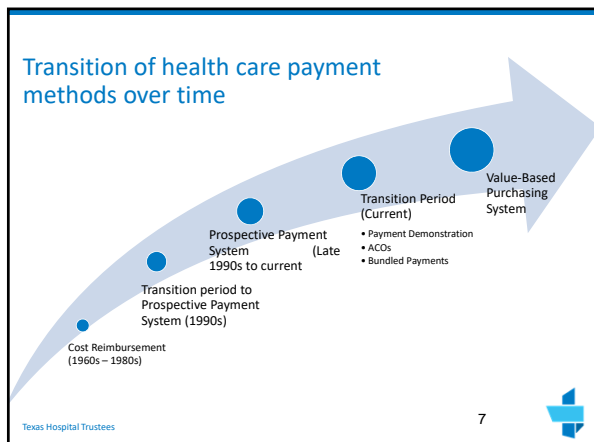
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### Payer Types

- Medicare is typically the largest payer in hospitals (volume and dollars)
- Other third party payer examples would be Medicaid, Blue Cross, Humana, other commercial insurance companies
- Other third party payers often follow or use Medicare to help in reimbursement
  - Develop other methodologies to fit their needs and budgets
  - Might use DRG's, fee for service, percentage of charges
  - Increasingly looking at quality and other information to move away from fee for service reimbursement
- Patients without insurance typically receive discount based on gross charges

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### Managed Care and Commercial Payers

- Rates are generally higher than Medicare/Medicaid
  - ❖ Many hospitals make their margin in this area
- Typical payment methods
  - ❖ Per diem rates
  - ❖ Case rates
  - ❖ Discounts from gross charges
  - ❖ Capitation
    - ✓ Limited in Texas

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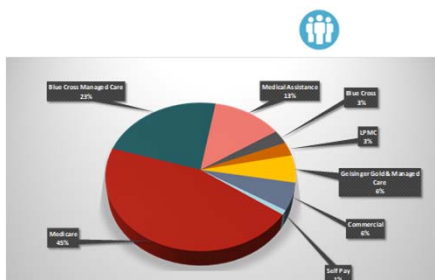
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### Payer Mix/Insurance Market



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### Common Payment Rates as % of Gross Charges

- Medicare Inpatient
  - ❖ 25% to 55% (although CAH may be over 100%)
- Medicare Outpatient
  - ❖ 10% to 35%
- Medicaid Inpatient
  - ❖ 15% to 40%
- Medicaid Outpatient
  - ❖ 10% - 20%
- Commercial and managed care
  - ❖ 30% to 65%
- Self-pay
  - ❖ 2% to 5%

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### Charity Care and Patient Collections

- Much attention has been focused on hospitals' collection policies
  - ❖ Provisions of Health Reform limit collection efforts
  - ❖ Some states have challenged exempt status
- The definition of charity care has evolved over time
- Why you should have an effective charity policy

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### Bad Debt Expense

- o The level of bad debt expense is highly dependent on a hospital's payer mix
  - ❖ Texas hospital bad debt rates range from 13% to 25% of net patient revenue depending on location
  - ❖ National averages for bad debts is closer to 6%
    - ✓ Texas' uninsured patient population contributes to higher bad debt levels
  - ❖ Many patients that are classified as bad debt likely would be charity cases if all documentation could be obtained

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### What is the Revenue Cycle?

- Fundamentals –
  - Charges
  - Cash
- Revenue Cycle is a combination of processes whose end result is cash (net revenue)



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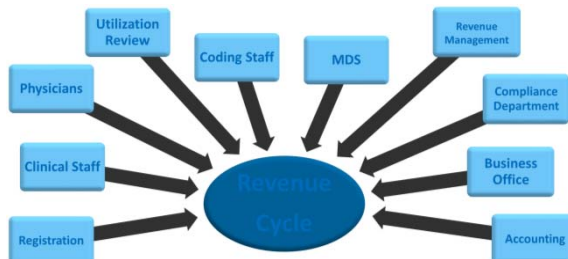
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Who's Responsible for Revenue Cycle Process? is a combination of processes whose end result is cash (net revenue)



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### Key Revenue Cycle Management Indicators

Key Performance Indicator	KPI	
Days from Discharge to Bill	3-5 days	12 days
Clean Claim Rate	95%	75%
Rebill % of Total Primary Claims Billed	<5%	No Report
Registration Accuracy Rate	97%	75%
Gross Days in A/R	40-50 days	55 days

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### Revenue Cycle Process

- Step 1- Scheduling of an appointment or Registration
- Step 2- Need documentation of the encounter
- Step 3- Need a bill – a culmination of the information provided by all of the above
  - Demographics
  - Payer
  - Charges
  - Certification
  - Codes
  - Bill is submitted to the payer

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### Revenue Cycle Process

Provider receives payment, denial or a request for additional information:

- If the claim is paid
  - Was it paid correctly – yes or no?
  - Is there a balance? – move to the next responsible party
- If the claim is denied
  - Do we have enough information to appeal?
  - Request for additional information
  - Do we have the additional information requested
- If ignored
  - We need to determine why

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### Chargemaster- one of most complex master files subject to frequent updates

- Database of code and charge information
- Maintained by Revenue Management
- Charges attach to codes (CPTs) and dollar amounts
- CPT – Current Procedural Terminology

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### Salary and Benefits Expense

- Industry averages for salaries % of net revenue (before bad debts):
  - ❖ CHIPS Urban Hospitals - 55%
  - ❖ S&P A Rated - 56%
  - ❖ S&P Small Hospitals A rated - 42%
  - ❖ Profitable hospitals range from 38% to 42%
  - ❖ Districts tend to be higher
- A hospital's structure will impact this
  - ❖ For example, hospitals that operate the ambulance service generally have a higher salary %
  - ❖ Hospitals with a very high percent may need to raise charges
- Employee benefits are generally 20 to 25 percent of salary costs

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### Non-Operating Income (Expense)

- For non-profit hospitals, non-operating income often includes:
  - ❖ Interest and dividend income
  - ❖ Unrealized gains and losses on investments
  - ❖ Other income and expense not directly related to operations
  - ❖ Hospitals do have some flexibility in what income or expense is categorized here
- Governmental hospitals also included interest expense and property tax revenues as part of non-operating income (expense)

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### Financial Statement Audit

- ▶ What is an audit?
  - Ensures the financial statements are materially correct
  - Testing of the financial statements and required disclosures for material accuracy and completeness
  - Part of planning an audit involves an assessment of internal controls related to the financial statements
- ▶▶ What an audit is not:
  - An examination of every transaction
  - To provide assurance of internal controls
  - Designed to detect immaterial errors or fraud

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### Cost Reports

- Detailed filing to Medicare showing the hospital's revenues and expenses
- Focus of report is on expenses and which expenses are "allowable" for Medicare purposes
- Used to help determine Medicare rates
- Other statistical and general information included for Medicare to evaluate the hospital

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### Income Statement

	2018	2017
<b>Unrestricted Revenues, Gains and Other Support</b>		
Patient service revenue (net of contractual discounts)	\$ 40,572,289	\$ 40,405,101
Provision for uncollectible accounts	(1,454,195)	(1,545,502)
Net patient service revenue less provision for uncollectible accounts	39,118,094	38,859,599
Other	2,038,123	1,800,085
Net assets released from restrictions used for operation	41,058	32,801
Total unrestricted revenues, gains and other support	41,197,275	40,753,085
<b>Expenses and Losses</b>		
Salaries and wages	18,511,917	19,987,457
Employee benefits	4,319,358	4,465,422
Supplies, purchased services and professional fees	15,671,786	13,952,362
Depreciation and amortization	2,163,734	2,315,196
Interest	262,884	284,531
Total expenses and losses	40,930,679	41,004,970
<b>Operating Income (Loss)</b>	266,596	(251,885)
<b>Other Income</b>		
Contributions received	297,204	288,183
Investment return	438,964	598,219
Gain on investments in equity investee	122,854	110,667
Total other income	859,022	997,069
<b>Excess of Revenues Over Expenses From Continuing Operations</b>	1,125,618	745,194
<b>Gain From Discontinued Operations</b>		7,629
<b>Excess of Revenues Over Expenses</b>	1,125,618	752,823
Investment return - change in unrealized gains and losses on other than trading securities	(300,906)	(171,040)
Change in fair value of interest rate swap agreement	(57,532)	(85,116)
Net assets released from restriction used for purchase of property and equipment	22,555	76,980
Distributions to noncontrolling interest	(733)	(53,600)
Change in defined benefit pension plan gains and losses	(560,876)	(349,065)
Contributions and grants for the acquisition of property	36,207	17,074
<b>Change in Unrestricted Net Assets</b>	\$ 264,331	\$ 190,045




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## Accounts Receivable

- Accounts Receivable - the second most important asset on the books
- Measured based on days
  - ❖ Days in Gross Receivables
    - ✓ How fast are accounts cleared from the books?
  - ❖ Days in Net Receivables
    - ✓ How conservative or aggressive are our allowances?
- Compare these measures to a benchmark each month; look for trend changes and differences compared to your peers.

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## Property and Equipment

- The largest asset for many hospitals is its investment in property and equipment
- Assets are added to the balance sheet based on their cost, and then depreciation is expensed over time based on the assets' estimated useful life
- Health care technology changes rapidly, often requiring significant investments in new facilities, equipment or information technology systems

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## Long-term Debt and Leverage

- Long-term debt is measured using:
  - ❖ Debt-to-capitalization ratio (35% is Moody average, lower is better)
  - ❖ Cash-and-investments to debt (157% is Moody average, higher is better)
  - ❖ Debt Service Coverage (5.1 is Moody average, higher is better)
- Debt pros and cons
  - ❖ Debt is often a necessity to modernize the facility and maintain liquidity
  - ❖ High debt levels can create high fixed costs, limiting operating options

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# Current Trends



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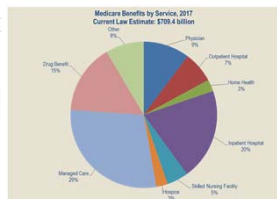
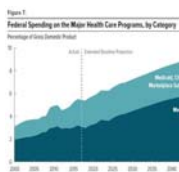
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## FEDERAL SPENDING

## MEDICARE BENEFITS



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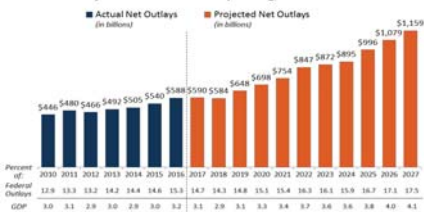
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Figure 4  
Actual and Projected Net Medicare Spending, 2010-2027



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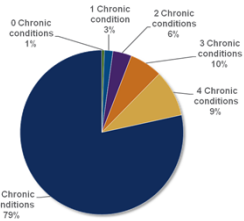
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## 2/3 of Medicare spending is for people with 5 or more chronic conditions

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## Chronic Care Management

- Chronic disease is a long-lasting condition that can be controlled but not cured
- Condition is expected to last at least 12 months or until death of patient
- Examples of chronic conditions (not all inclusive)
  - Alzheimer's disease & related dementia
  - Asthma
  - Cancer
  - Chronic Obstructive Pulmonary Disease
  - Diabetes
  - Heart failure
  - Hypertension

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## Healthcare is Changing! The Future of Healthcare is Based on Value

ACA brought Medicaid Expansion, Health Insurance Exchanges, ACOs and other initiatives

Moving from pay for volume to pay for value - better care, better population health, lower cost

Government - Commercial Payors - Consumers.... *all want the new system and not going back*

Hospitals and their medical providers struggle with the changes

$$\frac{\text{Quality + Service}}{\text{Cost}} = \text{Patient Value}$$

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### What's going on with the 1115 Waiver

- Changes to definition of Uncompensated Care/ Charity Care Policy Impacted by Changes
- Funding is expected to be lower state-wide due to this change
- CHAT Ruling update
- Prior Year DY2-6 Audits
- DSRIP Funding
- MFAR Update

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### Summary

- We discussed revenues and revenue processes in more detail than expenses on the Income Statements
- We discussed the Balance Sheet at a really high level
- The Healthcare Financial Challenge is really understanding how you get paid and why does it change year over year

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### Questions and Answers

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