

## Hospital Finance Basics: Part 1 Revenue

Hospitals operate in a unique economic environment. This Health Issues Brief describes hospital revenue sources and is the first in a four-part series about hospital finance.

### Introduction

Hospitals must generate revenue in order to provide their community with crucial health care services. The complex system of hospital financing includes a variety of revenue sources. A large portion of hospital revenue comes from government programs. The payment rates for these programs are set by law and typically do not cover the full cost of care. This brief provides an overview of government and other sources of hospital revenue and explains the challenges of public payer underpayment.

### Sources of Hospital Revenue

Operating revenue is the money earned directly by providing health care services to patients. It is the largest and most important source of hospital revenue. In 2011, according to the Florida Agency for Health Care Administration (AHCA), operating revenue represented 91% of all the money earned by hospitals in the state of Florida<sup>1</sup>. Hospitals also earn money from other sources such as gift shop sales, research grants, donations, and earnings on investments<sup>2</sup>.

### Payment Sources

Hospital operating revenue comes from two payment sources: public payers and private payers. Public payers are health insurance programs funded by the government including Medicare and Medicaid. Private payers include employer-sponsored health coverage, self-payments and individually purchased private health insurance such as the plans available through the new Health Insurance Marketplace.

The distribution of hospital payment sources is called "payer mix." It can be calculated in several ways: by patient volume, charges, costs and net revenue. Public payers represent the largest number of patients in the United States and at Florida Hospital.

### Important Terminology

**Beneficiary** – a patient whose care is paid for by a private or public payer.

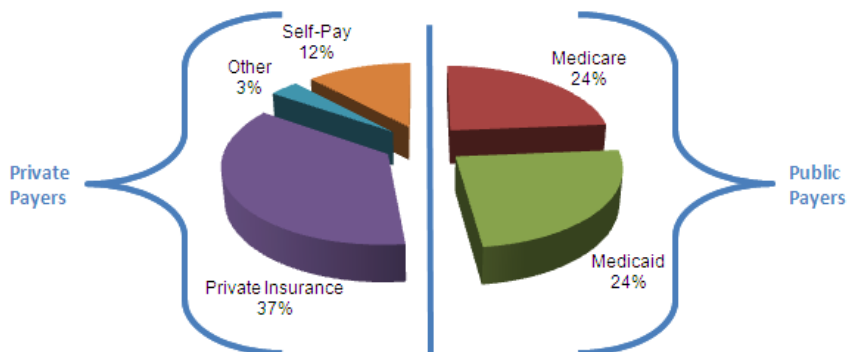
**Charge** – the uniform price hospitals list for each type of health care service. It is similar to the sticker price of a car at a dealership.

**Cost** – the amount of expense which the hospital incurs providing health care service.

**Payment** – the amount that is actually paid to the hospital for the health care services provided.

**Net Revenue** – the total amount of payments a hospital actually receives for the services it provides.

### Florida Hospital's Payer Mix by Patient Volume (2012)



## Public Payers

Medicare is paid by the federal government with taxes collected from employees and employers. It provides health coverage to individuals over the age of 65 as well as people with some specific disabilities. In 2011, Medicare covered 48.7 million people<sup>iii</sup>.

Medicaid is paid by both the federal and state government from taxes. Medicaid provides health coverage for eligible low-income individuals and families. It also covers people afflicted by certain chronic conditions or disabilities. It is estimated that 70.4 million people were enrolled in Medicaid for a least one month in 2011<sup>iv</sup>.

## Private Payers

Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs), Point of Service (POS) plans, and indemnity insurance are examples of private health care coverage. Beneficiaries of private health plans may be responsible for paying a part of their health care charges depending on the details of their plan. This is called cost-sharing and includes co-pay, co-insurance, and deductible payments.

## Payment Rates

Private health insurance groups typically negotiate discounted payment rates with hospitals. Conversely, Medicare and Medicaid hospital payment rates are non-negotiable. They are set by laws and administrative rules. Medicare pays hospitals a lump sum payment for each patient. The payment amount is determined by the patient's Diagnostic Related Group (DRG) for the patient's medical condition. Medicaid payment processes vary by state. In Florida, Medicaid typically pays hospitals using predetermined DRG rates similar to Medicare.

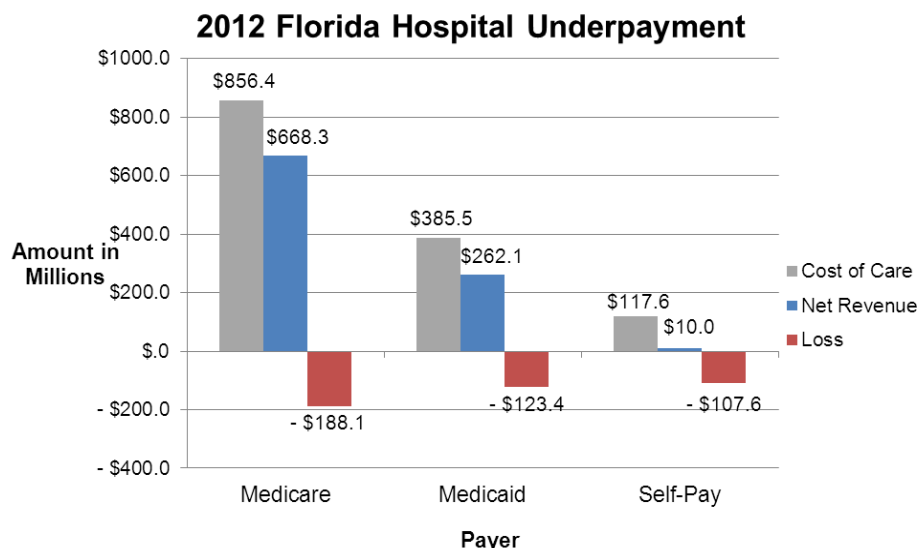
## Uncompensated Care

Uncompensated care includes charity discounts, bad debt, and underpayment from public payers such as Medicare and Medicaid.

### Government Losses

The non-negotiable payment rates of Medicare and Medicaid typically do not cover the actual costs of patient treatment. The shortfall between cost and reimbursement is called underpayment and is the main form of uncompensated care. The American Hospital Association reported that in 2010 aggregate Medicare payments to hospitals covered only 92% of the costs of treating Medicare beneficiaries<sup>v</sup>. It also found that total Medicaid hospital reimbursement covered only 93% of costs<sup>v</sup>.

In 2012, Medicare payments to Florida Hospital covered only 78% of the total cost of caring for Medicare beneficiaries<sup>vi</sup>. In the same year, Medicaid payments covered just 68% of the total cost of treating Medicaid patients at Florida Hospital<sup>vi</sup>.



## Bad Debt

Bad debt refers to payments that a hospital reasonably expects to receive but does not. The biggest contributors to bad debt are co-pays, deductibles and co-insurance unpaid by privately insured patients as well as uninsured patients who were financially capable of paying some of their charges but chose not to. In 2012, bad debt totaled \$93 million at Florida Hospital<sup>vi</sup>.

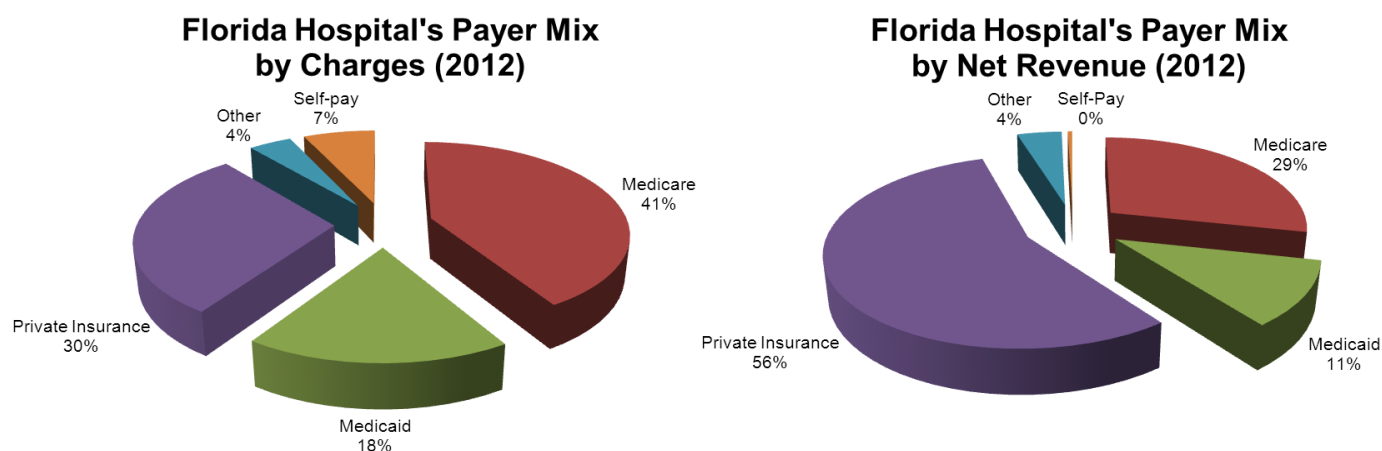
## Charity Discounts

Charity care includes services provided for free or at a discount depending on a patient's financial need. Florida Hospital's Financial Assistance Program provides charity discounts to patients with annual household incomes of less than 400% of the Federal Poverty Level (currently \$94,200 for a family of four). Calculated at cost, Florida Hospital provided \$127 million of charity care in 2012<sup>vii</sup>.

## Cost-Shifting

In order to maintain a sustainable financial status, hospitals negotiate payment rates from private insurance groups. The margins on these payments subsidize hospital losses from public payer underpayment, bad debt and charity care. This is known as cost-shifting, and can result in higher premiums for privately insured individuals.

In 2012, beneficiaries of Medicare and Medicaid received nearly 60% of the clinical services provided by Florida Hospital (as measured by charges)<sup>vi</sup>. However, payments from these government programs represented just 40% of Florida Hospital's total net revenue<sup>vi</sup>. In comparison, private payers received 30% of the care provided by Florida Hospital and represented 56% of its total net revenue<sup>vi</sup>.



## Key Takeaway

The most important source of hospital funding is the money earned by providing health care services. However, hospitals such as Florida Hospital have no ability to negotiate the payments from the public payers – Medicare and Medicaid – that pay for the majority of the clinical services provided. This poses a tremendous financial challenge for hospitals because these payments do not cover costs. In order to overcome these shortfalls, hospitals negotiate higher rates from private insurance groups. For this reason, continuing cuts to Medicare and Medicaid payments create an unsustainable business environment and put undue financial pressure on private payers. Hospitals are working to solve this problem. Payment methodology changes and improved delivery system alignment may provide some relief over the next few years.

Part two of this series will examine hospital costs and explain why delivering hospital care is an expensive, labor intensive, and narrow margin business.

<sup>i</sup> "2011 Hospital Financial Data," Florida Agency for Health Care Administration, Financial Analysis Office. 2012

<sup>ii</sup> "A Community Leader's Guide to Hospital Finance," Sarah Lane, et al. The Access Project. 2001

<sup>iii</sup> "2012 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds," The Boards of Trustees for Medicare. 2012

<sup>iv</sup> "2012 Actuarial Report on the Financial Outlook for Medicaid," Truffer, Klemm, Wolfe, Rennie, and Shuff. Centers for Medicare & Medicaid Services. 2012

<sup>v</sup> "American Hospital Association Underpayment By Medicare and Medicaid Fact Sheet," American Hospital Association. 2012

<sup>vi</sup> Florida Hospital, Finance Department. 2012

<sup>vii</sup> Florida Hospital, Accounting Department. 2012