

Hospital Financial Analysis 2001

February, 2002

The Pennsylvania Health Care Cost Containment Council is an independent state agency charged with addressing the cost and quality of health care in Pennsylvania.

In order to maintain a high quality, cost-effective health care delivery system, hospitals and freestanding surgery centers must be financially viable and effectively managed. To this end, the Council has produced a series of annual reports that measure the financial health of the Commonwealth's hospitals and surgery centers and the utilization of their services.

In response to the high level of interest in the financial health of Pennsylvania's general acute care hospitals, the Council is releasing this *Preview* in advance of its forthcoming *Financial Analysis 2001*, to be released in Spring 2002.

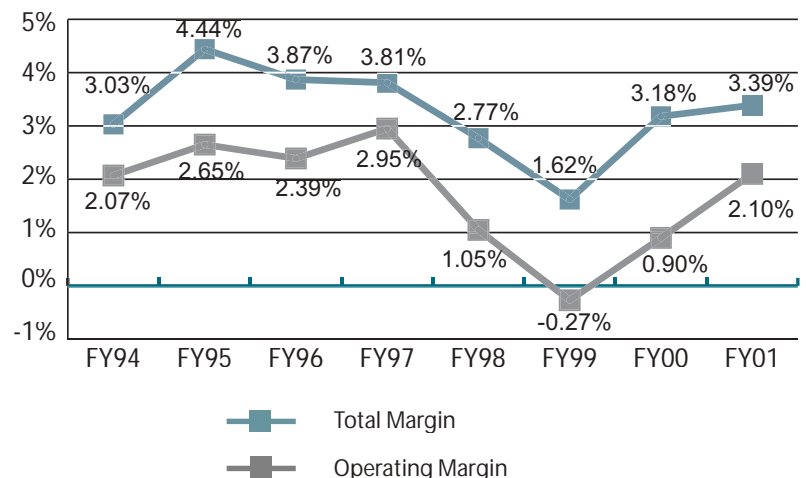
The information summarized in this *Preview* comes from audited hospital financial statements and its accuracy is dependent on the quality of the hospitals' data submission efforts. This year, 188 of Pennsylvania's 189 general acute care hospitals submitted financial data to PHC4, a near perfect record of compliance. PHC4 wishes to thank the hospitals for their cooperation and timeliness.

The Financial Health of GAC Hospitals Continues to Improve

The overall financial health of Pennsylvania's 189 general acute care (GAC) hospitals took another positive step forward during the 2001 fiscal year (FY01). After four years of decline between FY95 and FY99, total margin has improved for the second consecutive year. Based on the Council's preliminary data, the statewide average total margin rose about 2/10 of a point from 3.2% during FY00 to 3.4% during FY01.

Total margin reflects the "net income" hospitals receive from all sources, including patient care, investment income and contributions. Net income grew by about \$73 million from \$611 million in FY00 to \$684 million in FY01. Net income is also known as "revenue over expenses" for non-profit hospitals and "net after-tax income" for for-profit hospitals. Without positive net income, hospitals are unable to finance improvements to their facilities and equipment.

Average Total and Operating Margin



More significant growth was seen in the statewide average operating margin which improved 1.2 points from about 0.9% in FY00 to 2.1% in FY01. Operating margin demonstrates the extent that the fees hospitals receive for patient care and other services compare to the costs for providing those services. During FY01, Pennsylvania GAC hospitals realized a little more than two cents (2.1¢) of income from every dollar of revenue from operations.

One-Third of GAC Hospitals Lost Money

Despite the improvement in statewide income, 33% or 62 of the 189 GAC hospitals lost money in FY01. This is an improvement over FY00 when 35% or 67 of the 194 GAC hospitals had negative total margins.

However, 70% of the Pennsylvania GAC hospitals that either sustained less severe losses or realized modest positive income had higher total margins during FY01 than the hospitals in these groups did during FY00. In contrast, the 5% of GAC hospitals that had the lowest total margins and the 25% of GAC hospitals that had the highest total margins had lower margins in FY01.

While a few less hospitals lost money in FY01, the number of hospitals that lost money over a three-year period did not change between FY00 and FY01. The number of hospitals that reported negative average total margins over the three-year periods FY99 - FY01 and FY98-FY00 remained steady at 69 hospitals.

Decline in Non-Operating Income is Offset by Growth in Operating Income

For the first time in three years, income from operations was larger than income from non-operating sources, such as investment income and contributions. During FY01, about 61% of statewide total hospital income or \$417 million was earned from operations. In contrast, only 28% of hospital income or \$170 million came from operations just a year earlier. This dramatic shift is the result of both a \$174 million decline in non-operating sources and a \$247 million growth in operating income.

Revenue Grew Faster than Expenses

Statewide operating income improved because hospitals were able to keep the growth in expenses below the growth in revenue. GAC hospitals

collectively received about \$19.9 billion in operating revenue during FY01, an increase of about 5.8% over the previous year. Statewide operating expenses grew 4.5% to a total of \$19.5 billion.

Net patient revenue (NPR), the revenue hospitals receive for patient care, grew at about the same rate as overall hospital revenues. NPR increased about 5.9%, or \$1.0 billion, to a statewide total of \$18.8 billion. NPR represented about 94% of total operating revenue during FY01.

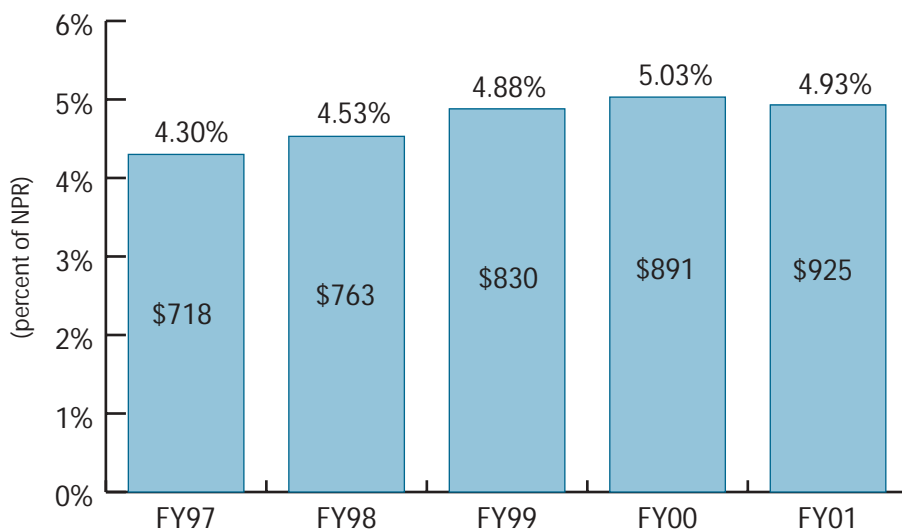
Uncompensated Care Levels Slowed

The dollar amount of uncompensated care reported by Pennsylvania's GAC hospitals during FY01 grew by about 3.8% to about \$925 million. During the three years prior to FY01, uncompensated care grew an average of 7.2% per year.

While the dollar amount of uncompensated care grew, the portion of total care that was left unpaid declined slightly. Uncompensated care was equal to about 4.9% of statewide NPR during FY01, a slight decline from the 5.0% during FY00. NPR grew a little faster than uncompensated care.

The level of bad debt posted by hospitals declined about 2.3% during FY01. Bad debt now makes up about 74% of statewide uncompensated care. In contrast, the level of charity care reported by hospitals grew about 27% and now represents about 26% of statewide uncompensated care.

Statewide Uncompensated Care



Uncompensated care is shown in millions of dollars

How Uncompensated Care is Reported

Uncompensated care is comprised of charity care and bad debt expense.

Charity care is the care that hospitals provide when they determine a patient is unable to pay through third-party coverage or the patient's own resources. Hospitals have varying procedures for determining a patient's ability to pay and different policies on granting charity care.

Because policies and procedures related to uncompensated care vary from hospital to hospital, it is difficult to make a distinction between charity care and bad debt expense on a statewide basis. What one hospital may record as a bad debt expense another hospital may categorize as charity care. Consequently, bad debt and charity care are reported together as uncompensated care.

The Pennsylvania Health Care Cost Containment Council presents uncompensated care on a foregone revenue (NPR) basis. Uncompensated care reflects the revenue hospitals would have received if patients receiving charity care had paid the average fees received on behalf of all other patients. Bad debt is reported as the unpaid portion of patients' outstanding bills.

What is Included in Charity Care

All services and materials that are provided to the general public under an established fee are eligible to be included in charity care. Consequently, the costs of important public health programs are not included. Hospitals frequently report these activities separately.

Some hospitals report the difference between the reimbursement they receive from government-funded programs, such as Medical Assistance, and their customary fees or charges as a component of charity care. These differences are not included in the uncompensated care levels reported by the PHC4. However, if a patient fails to pay a required co-payment, or receives care beyond the range of services covered by a third-party payor, these foregone revenues may be included in charity care or bad debt.



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