A Preview

Hospital Financial Analysis 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 2002*, to be released in Spring 2003.

The information summarized in this *Preview* comes from the hospitals' audited financial statements. This year, all 185 general acute care hospitals submitted financial data to PHC4. The Council wishes to thank the hospitals for their cooperation and timeliness.

The Financial Health of GAC Hospitals Deteriorated During FY02

The overall financial health of Pennsylvania's general acute care (GAC) hospitals deteriorated during the 2002 fiscal year (FY02). A sharp decline in non-operating income coupled with level operating income caused the statewide average total margin to fall more than a full point from 3.29% in FY01 to 2.26% in FY02. The total margin reflects the "net income" hospitals realize from all sources.

Statewide Operating Margin Levels Off

After two years of steady improvement in the statewide average operating margin, the income GAC hospitals realized from operations remained relatively constant at 2.05% during the 2002 fiscal year (FY02). Operating margin reveals the extent that the fees hospitals receive for patient care and other services compare to the costs of providing those services. For the second year in a row,

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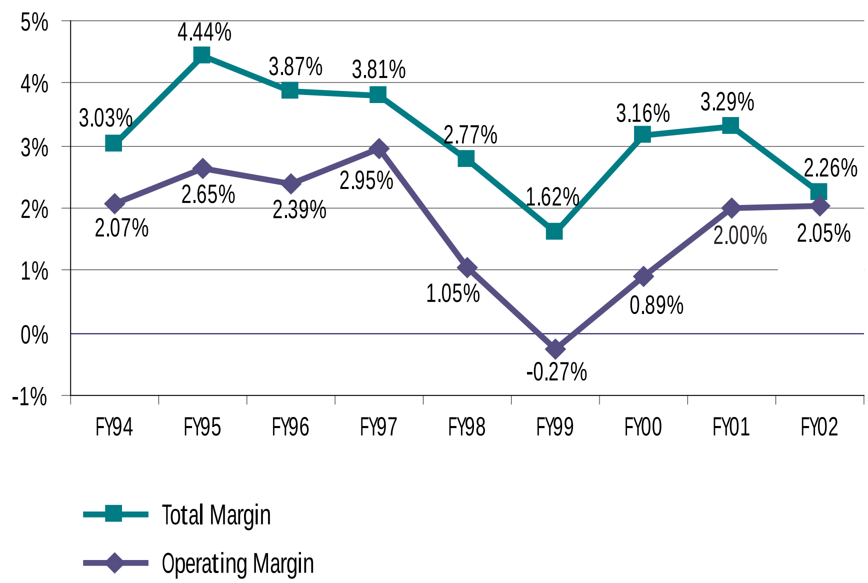
Statewide Average Total and Operating Margin



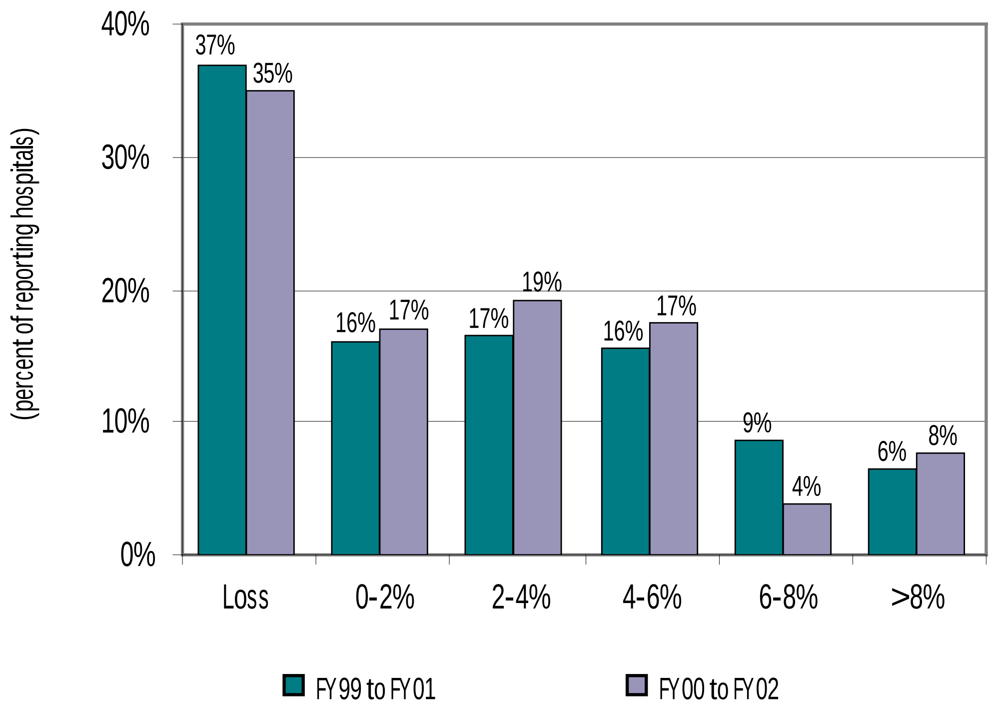
hospitals realized about two cents (2¢) of income for every dollar they receive in revenue.

Non-Operating Income Tumbles

The GAC hospitals reported total statewide non-operating income of about $46.5 million, an 82% decline compared to the $265.6 million reported in FY01. This decline in statewide non-operating income was driven largely by declines in the income hospitals receive from their investments as well as losses in the value of the securities held by hospitals.

One hundred seventy (170) of the 185 GAC hospitals are operated as non-profit corporations. Consequently, Pennsylvania's GAC hospital industry relies heavily on non-operating income such as investment income and contributions to sustain its operations.

Statewide Distribution of Three-Year Average Total Margins



N=187 *N=183*

Since total margin is still positive, the industry as a whole is realizing enough revenue to pay its expenses. However, the decline in the total margin indicates that the industry may find it more difficult to replace worn-out or obsolete equipment and to finance improvements to their facilities and equipment.

Over 40% of GAC Hospitals Lost Money

Consistent with the sharp decline in non-operating income, the percentage of hospitals that lost money grew to 41% during FY02 compared to 34% during FY01. Seventy-six (76) of the 185 GAC hospitals reported negative total margins for FY02.

While more hospitals posted losses for FY02, the percentage of hospitals that sustained average losses over the past three years remained relatively constant. At the end of FY02, 35% of GAC hospitals had negative 3-year average total margins compared to 37% for the 3-year period ending in FY01. The relative stability in the distribution of 3-year average total margins is to some extent a reflection of the fact that the overall hospital income in FY02 is still better than it was during FY99.

Uncompensated Care Grows

The dollar amount of uncompensated care grew 12.91% to $979 million during FY02. However, since statewide patient revenue grew by nearly 8% during the year, the growth in the portion of care that GAC hospitals provided without reimbursement actually experienced a more modest growth from 4.62% in FY01 to 4.84% in FY02.

What is Included in Uncompensated Care

Uncompensated care is comprised of bad debt and charity care.

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

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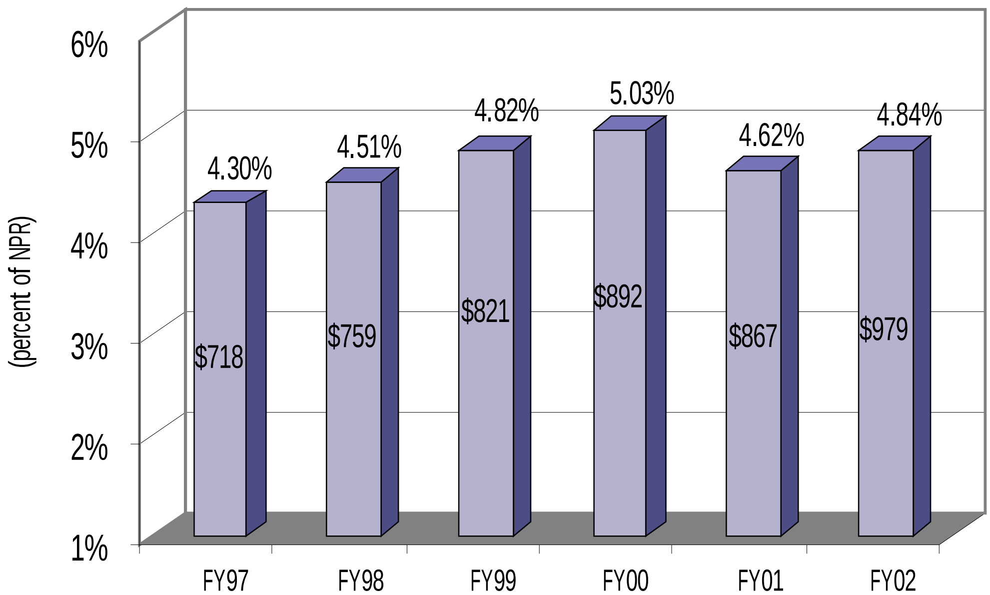
Statewide Uncompensated Care



Uncompensated care is shown in millions of dollars

Some hospitals include 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 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.

As directed by the Tobacco Settlement Act (Act 77), adopted by the General Assembly in June 2001, the Council will modify the way uncompensated care is reported. Beginning with FY03, uncompensated care will be reported as the hospitals' costs of providing care.

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