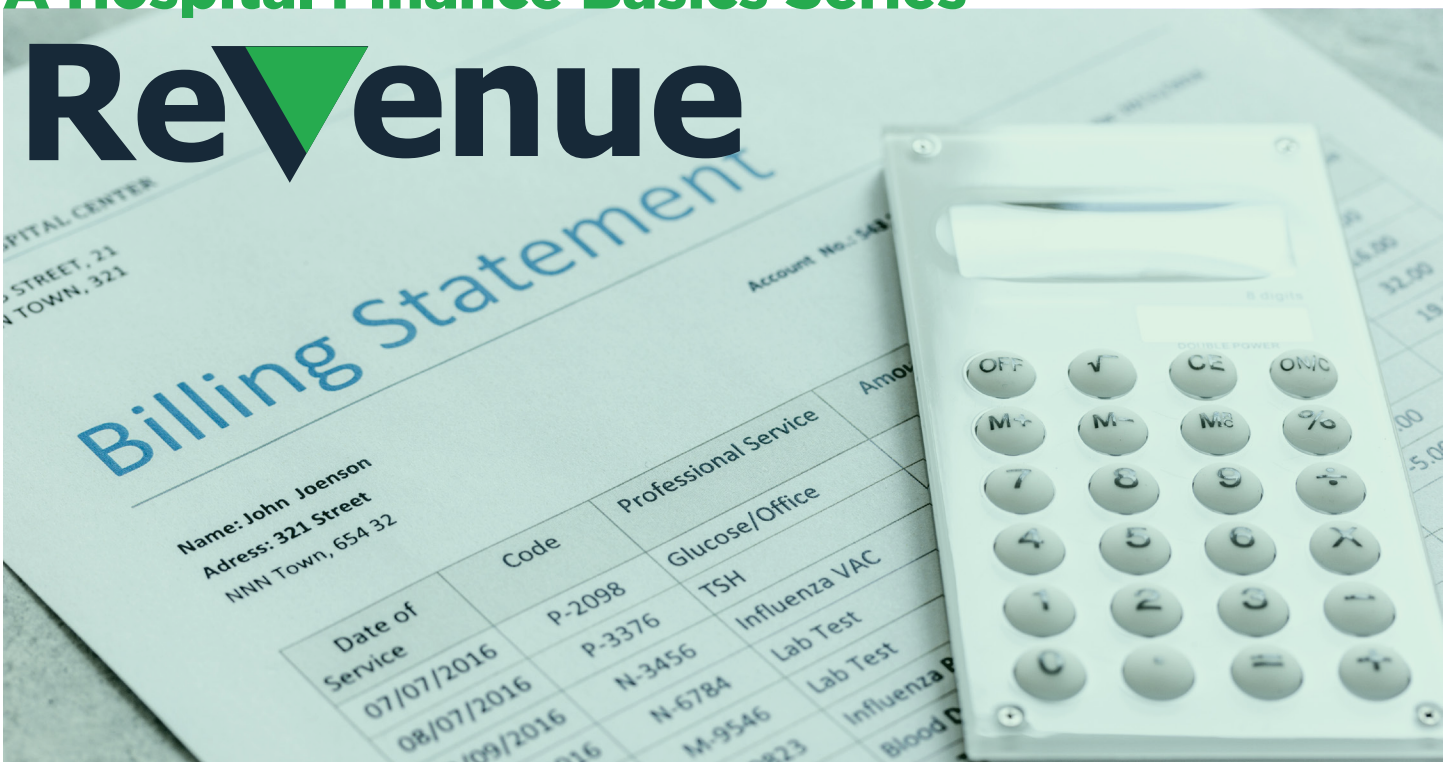
A Hospital Finance Basics Series

Revenue



Hospitals operate in a unique economic environment. This instructional brief describes hospital revenue sources and is the first in a series about hospital finance. KHA is available to answer your questions about hospital finance. Please reach out to Shannan Flach, Vice President Finance for additional information: sflach@kha-net.org or call (785) 233-7436.

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 2019, operating revenue represented 99 percent of all the money earned by hospitals in the state of Kansas.[i] Hospitals also earn money from other sources such as gift shop sales, research grants, donations and earnings on investments.[ii]

FINANCE 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.

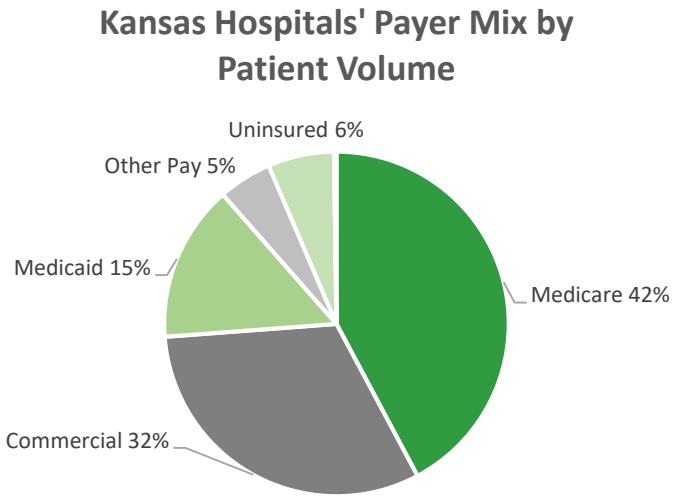
Net Revenue – the total amount of payments a hospital actually receives for the services it provides versus what it charges.

KHA Kansas Hospital ASSOCIATION

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, individually purchased private health insurance such as the plans available through the new Health Insurance Marketplace and private payers on behalf of the government such as Medicare Part C plans.

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 Kansas hospitals.



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 2022, Medicare covered 58.6 million people.[iii] **In Kansas, half a million people are covered by Medicare.**[iv]

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 90.6 million people were enrolled in Medicaid for at least one month in 2022.[v] **In Kansas, on average, about 360,000 people are enrolled in Medicaid each month.**[vi]

PRIVATE PAYERS

Health Maintenance Organizations, Preferred Provider Organizations, Point of Service 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 periodically 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 (Critical Access Hospitals are cost-based reimbursed). The payment amount is determined by the patient's Diagnostic Related Group for the patient's medical condition. Medicaid payment processes vary by state. In Kansas, Medicaid typically pays hospitals using predetermined DRG rates similar to Medicare.

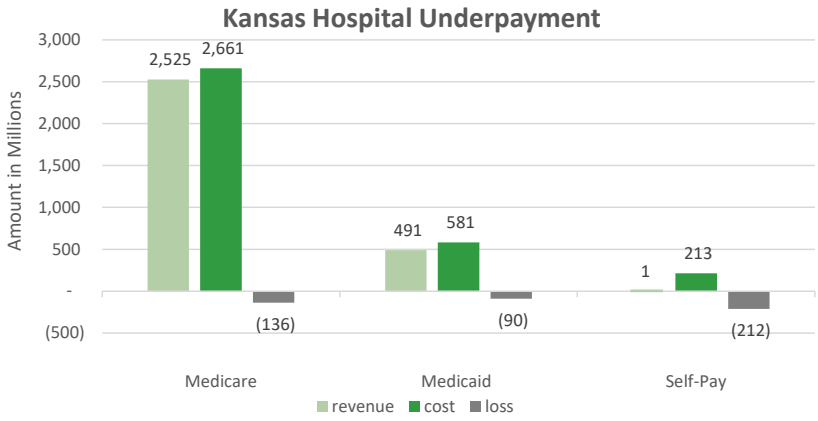
UNCOMPENSATED CARE

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 2019 aggregate Medicare payments to hospitals covered only 87 percent of the costs of treating Medicare beneficiaries.**[vii] It also found that **total Medicaid hospital reimbursement covered only 90 percent of costs.**[viii]

In 2019, Medicare payments to Kansas Hospitals covered only 94 percent of the total cost of caring for Medicare beneficiaries.[ix] In the same year, Medicaid payments covered just 84 percent of the total cost of treating Medicaid patients at Kansas hospitals.[x]



Some Kansas hospitals operate at a consistent loss in revenue which may jeopardize services, access to care and overall health.

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 and uninsured patients who were financially capable of paying some of their charges but chose not to. **In 2019, bad debt totaled $1.0 billion at Kansas hospitals.**[xi]

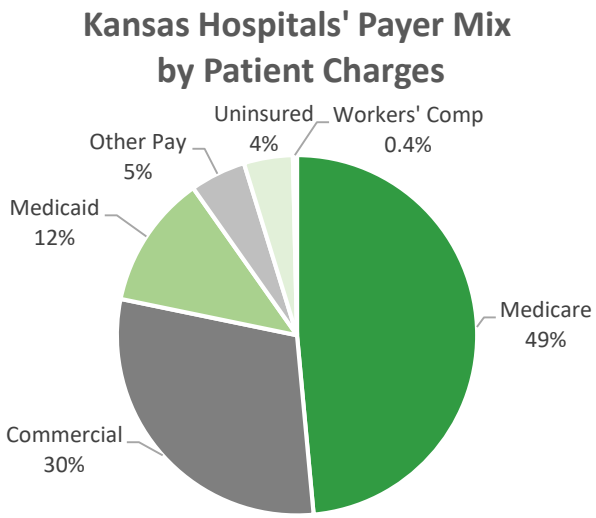
CHARITY DISCOUNTS

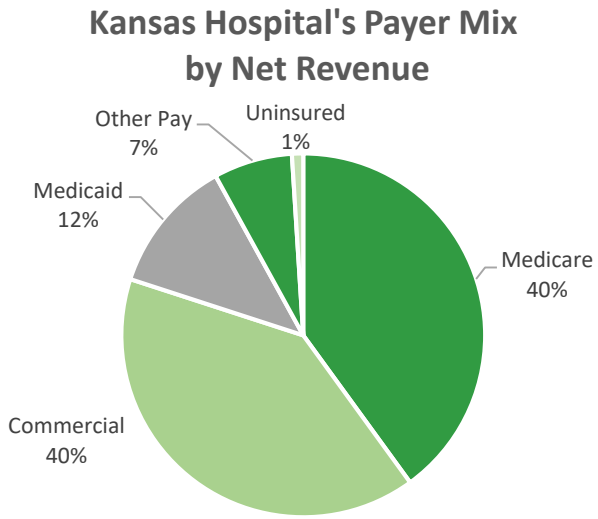
Charity care includes services provided for free or at a discount depending on a patient's financial need. Kansas Hospital's Financial Assistance Programs provide charity discounts to medically indigent patients. Calculated at cost, **Kansas hospitals provided $257 million of charity care in 2019.**[xii]

COST-SHIFTING

In order to maintain a viable financial status, hospitals attempt to 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 2021, beneficiaries of Medicare and Medicaid received nearly 61 percent of the clinical services provided by Kansas hospitals (as measured by charges).[xiii] However, payments from these government programs represented just 52 percent of Kansas hospitals' total net revenue. In comparison, private payers received 30 percent of the care provided by Kansas hospitals and represented 40 percent of its total net revenue.[xiv]





KEY TAKEAWAY

The most important source of hospital funding is the money earned by providing health care services. However, Kansas hospitals 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. When payments do not cover costs, hospitals may need to resort to local tax support for funding.

Hospital care, on average, is a narrow margin business. Positive margins ensure hospitals are able to hire highly trained caregivers, invest in improved facilities and utilize the latest technology.

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

SOURCES

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ix. "Medicare Margins Report", HANYS/DataGen. 2022

x. "2019 Kansas Hospital Cost Report Data, Kansas Hospital Association Financial Analysis. 2022

xi. "Kansas Hospital Association, American Hospital Association Annual Survey. 2022

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xiii. "2020 Kansas Hospital Claims Data, Kansas Hospital Association Financial Analysis. 2022

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