Introduction to Hospital Financial Affairs

Presenter

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July 2022

Today's Goals

- Revenue Sources to help you better understand how you get paid for services- Medicare
- Balance Sheet and Financial Performance Indicators
- Roles and Responsibilities of a Board Member

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

Keys to Understanding Healthcare Finance

- Board members need to understand how you are paid
  - ❖ Medicare, Medicaid, Commercial, PPOs, etc.
- Board members need to understand all about revenues and the income statement
- Board members need to understand key items on the hospital's balance sheet

Key Healthcare Finance Terms

- Medicare – Insurance for the aged (generally over 65)
- Medicaid – Insurance for the poor; generally managed by the state
- Financial Class – Patient grouping based on type of third-party payer (i.e., Medicare, Medicaid, Blue Cross)
- Case Mix Index – Measure of a patient acuity; a higher case mix indicates a sicker patient
- Cost Report – Annual information filing required by Medicare and Medicaid, which reports patient statistics and costs

Key Healthcare Abbreviations

- CMS – Center for Medicare and Medicaid Services; federal agency that administers Medicare and Medicaid programs
- Novitas- Contractor for CMS that receives and pays claims to hospitals
- PPS – Prospective Payment System; most common Medicare payment system
- DRG – Diagnostic Related Group, which is used by Medicare to pay hospitals for inpatient services
- APC – Ambulatory Payment Classification, which is used by Medicare to pay hospitals for outpatient services
- DSH – Disproportionate Share Hospital payment; an add-on to Medicare and Medicaid payments to partially reimburse hospitals for high levels of indigent care
- FTE – Full-time equivalent employee, which is an employee that worked 2,080 hours

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

Net Patient Service Revenue

- Understanding this income statement line is often the most difficult for board members
- One of the most “unique” areas of health care
- The challenge
  - ❖ Project how many patients will “choose” not to pay you
  - ❖ Estimate Insurance payments
  - ❖ Forecast denials and unexpected financial class changes
- This is an educated estimate supported by analysis

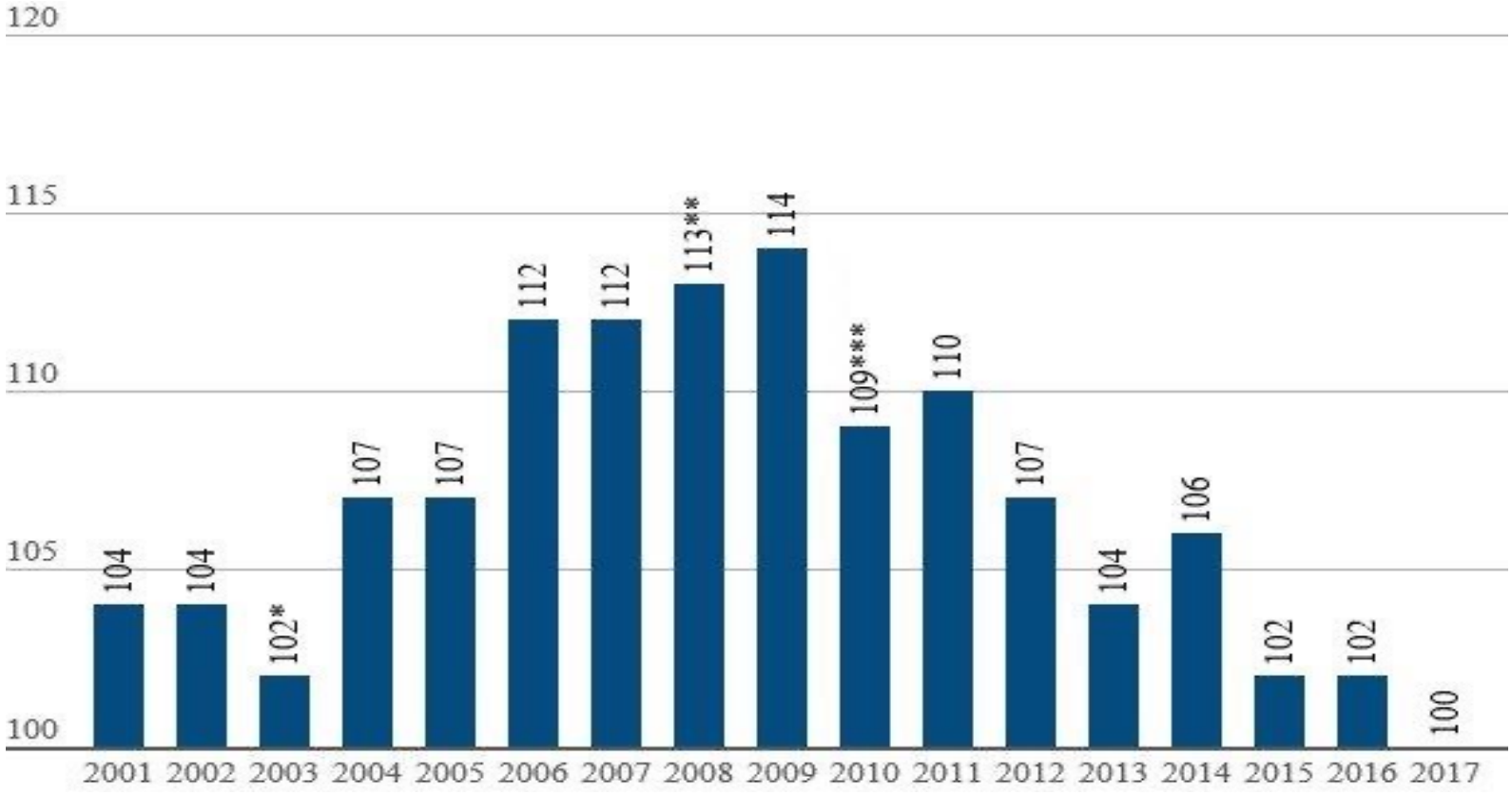
NPSR Key Terms

- 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

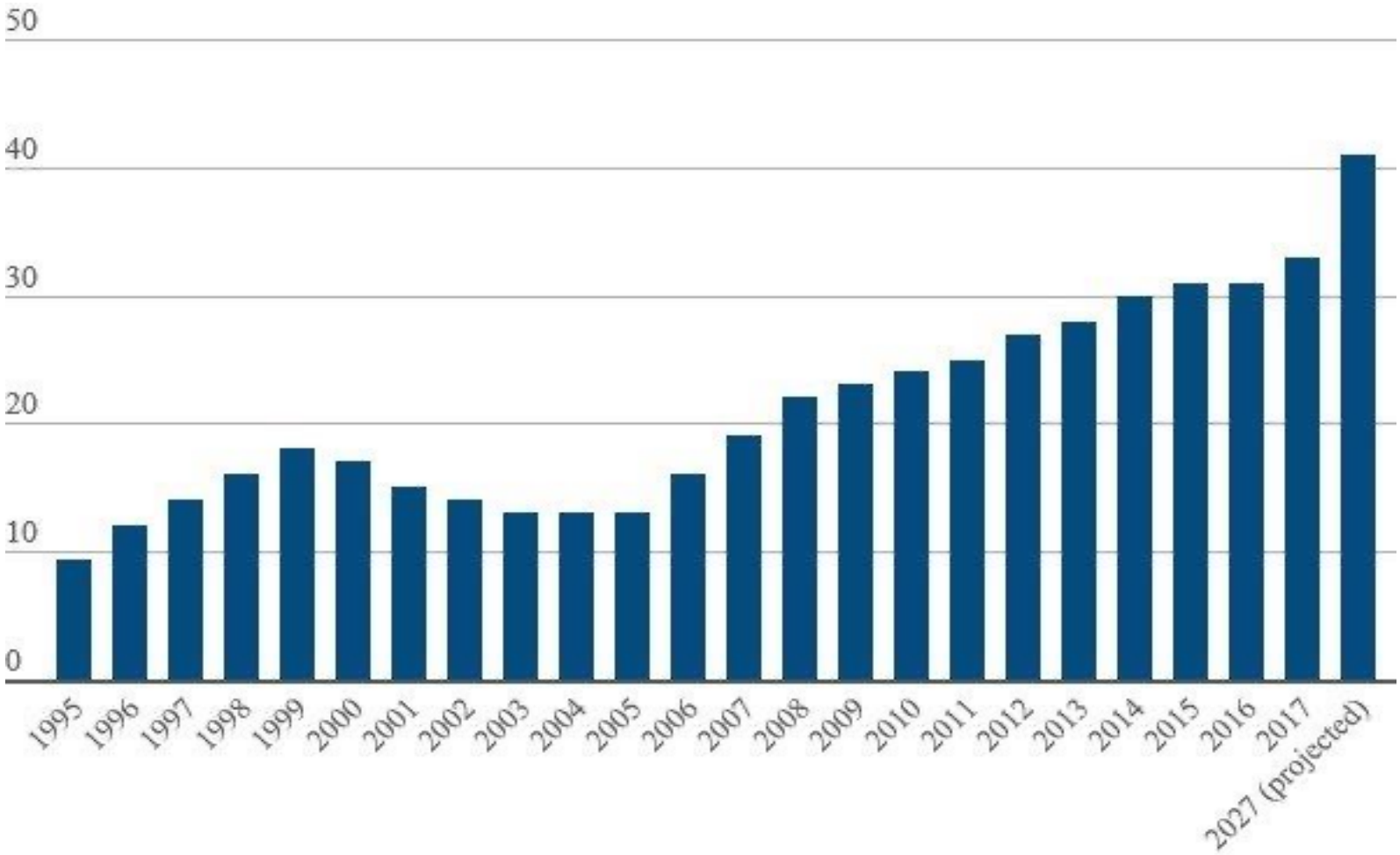
Medicare History

- Medicare was started in 1965 and provides insurance primarily to U.S. residents over age 65
  - ❖Provides coverage to over 40 million beneficiaries
- Medicare initially covered inpatient hospital/long-term care benefits (Part A) and outpatient and physician services (Part B). In recent years, a drug benefit was added (Part D).
  - ❖Medicare Advantage plans fall under Part C of the Medicare program
- Medicare is administered by CMS from Baltimore, Maryland. CMS hires "Medicare Administrative Contractors" to pay claims to providers, audit cost reports and enroll new providers
- Medicare requires patients to pay as much as 20% of the amounts due to providers as coinsurance and/or deductibles

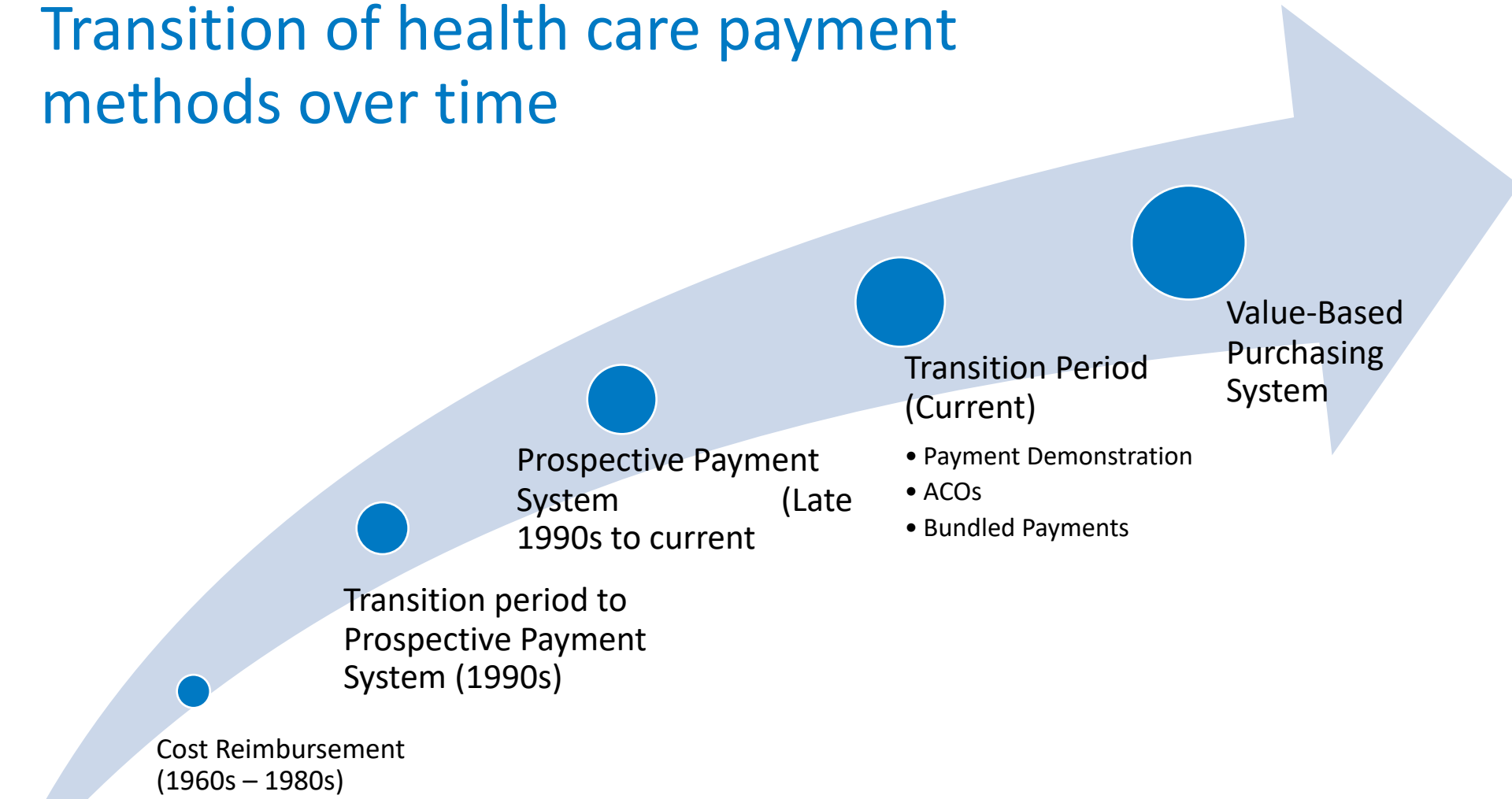
Medicare Private Plan Payments Relative to Traditional Medicare Spending



Medicare Private Plan Penetration (%)



Transition of health care payment methods over time



Medicare Payment Methods

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

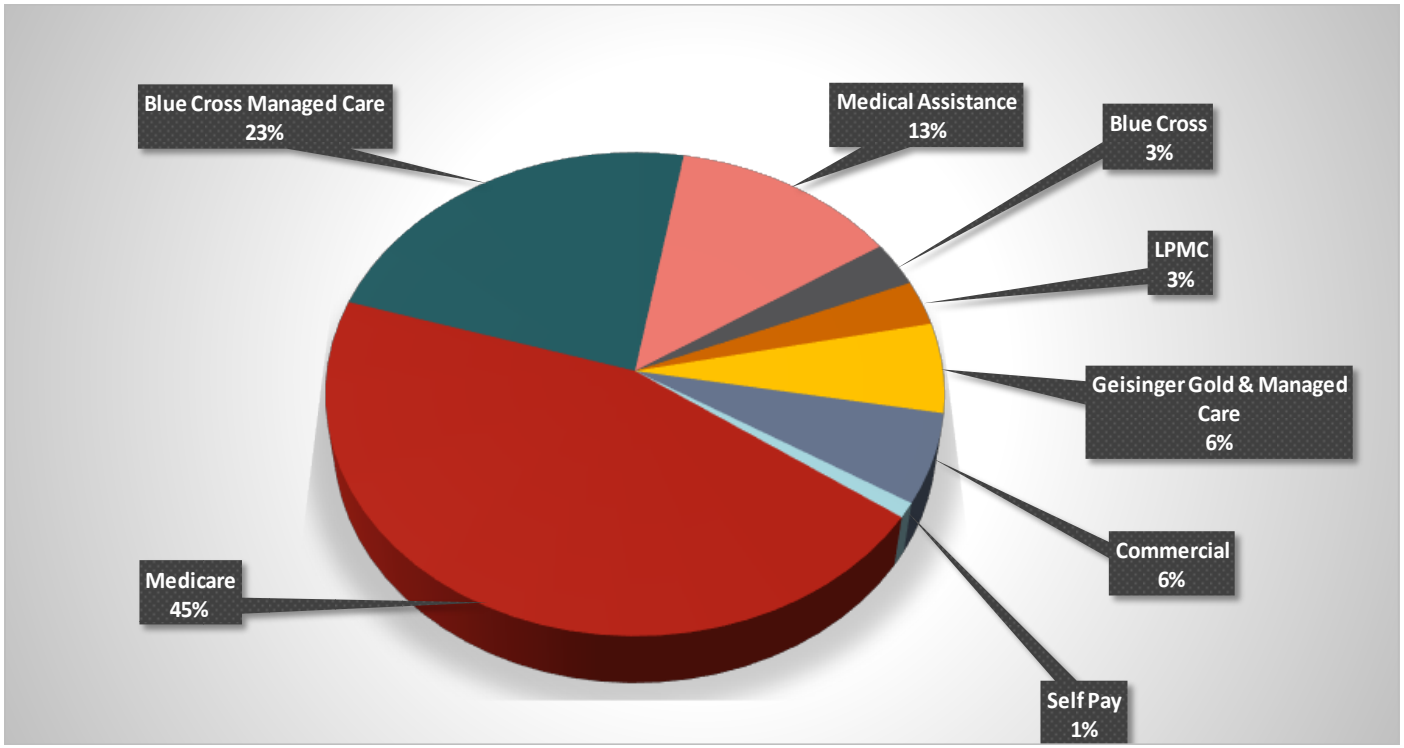
Medicare Inpatient PPS (DRGs)

- Payments are based on a prospectively determined amount per discharge rate
- Varies based on the acuity (or case mix) of each patient
- About 2/3 of the payment is based on the geographic area where a hospital is located
- The DRG payment generally does not change based on the patient's length of stay or the amount of charges
- Case mix adjustment impacts payment

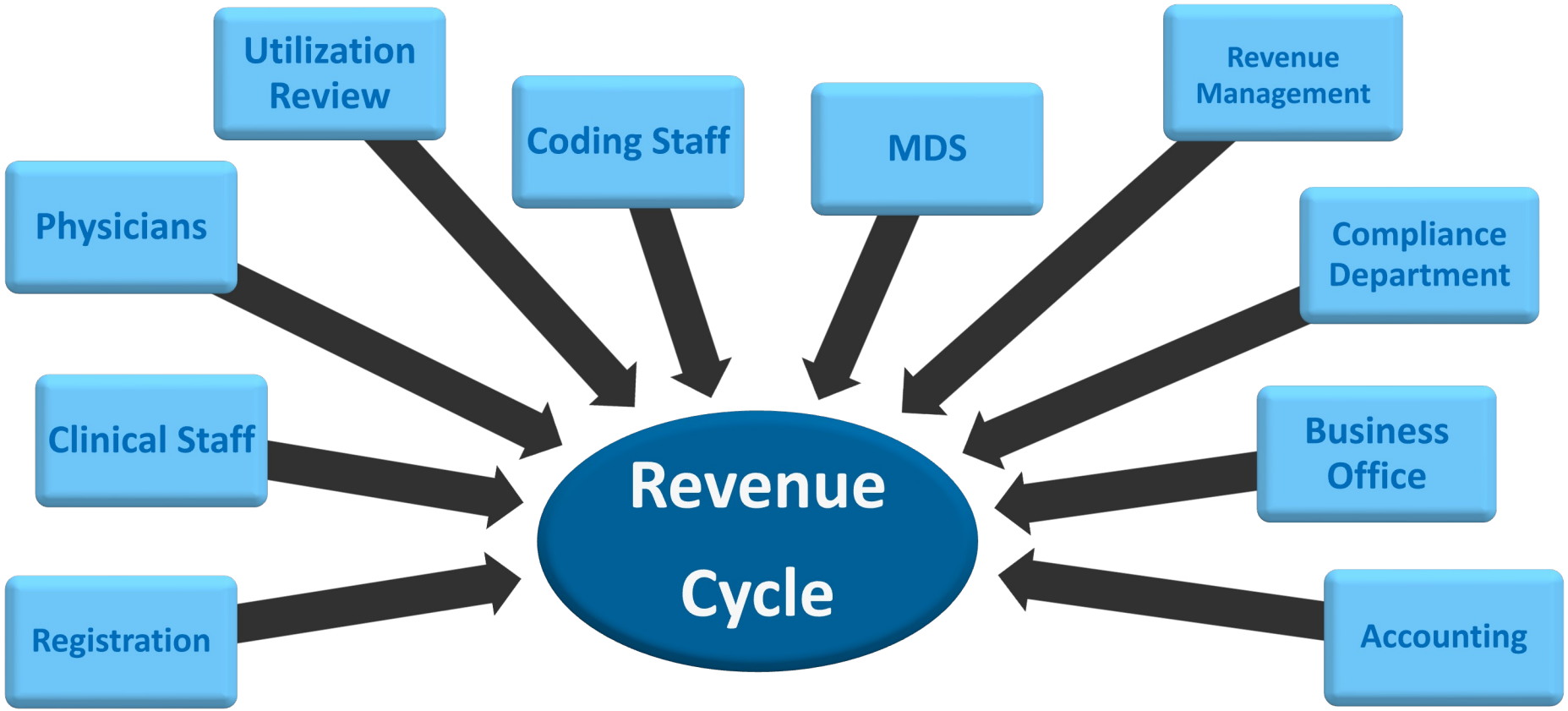
Critical Access Hospitals

- Receive cost based payments for Medicare services
  - ❖Inpatient payments are based on average cost per inpatient day
  - ❖Outpatient payments are based on the ratio of costs to charges in each department multiplied by Medicare charges
- Potential for large cost report settlements

Payer Mix/Insurance Market



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



Key Performance Indicators (KPIs)

Revenue Cycle

Initiative	Hospital X	HBI 2021 Average	HBI 2021 Top Quartile
Front			
Point-of-Service Collections as a % of Net Revenue	0.01%	0.7%	0.9%
Clean Claim Rate	69.6%	> 85.0%	> 85.0%
Back			
Gross Days in AR	58.6	46.8 Days	42.2 Days
Insurance Billed AR > 90 Days	28.9%	22.3%	17.9%
Self Pay AR > 90 Days	61.1%	48.7%	43.2%
Denial Write-Offs as a % of Gross Revenue	3.8%	0.6%	0.2%
Denial Write-Offs as a % of Net Revenue	2.7%	1.7%	0.8%

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 collection improvements
- Employee benefits are generally 20 to 25 percent of salary costs

How Do You Use a Balance Sheet?

- The balance sheet represents a snapshot of a hospital's assets and liabilities at a particular date
- Timing differences can impact initial interpretation
  - Look for major changes since last year, especially in working capital
  - Use benchmarks to measure balance sheet status vs. aggregate numbers
    - ✓ Days cash on hand
    - ✓ Days in accounts receivable
    - ✓ Days in accounts payable
- One best practice is to show a comparison of the monthly balance sheet to the last year-end audit

Cash and Investments

- Hospitals cash and investments are reported in various areas on the balance sheet
  - ❖ Unrestricted amounts are shown as “Cash and cash equivalents” and “Investments”
  - ❖ Restricted amounts (including board designated investments) may be shown as “Assets limited as to use”
- Cash and Investment restrictions often relate to malpractice funds, donor restricted funds and funds restricted under debt agreements
- Cash is generally measured by the number of days cash on hand (that is, how many days of operating expenses are in the bank)

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.

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

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

Things to watch as a Board Member

Roles/Responsibilities of Board of Directors

1. Establish Vision, Mission and Values- guide and set the pace for its current operations and future development
2. Set Strategy and Structure- determine the business strategies and plans and ensure the company's organizational structure is appropriate to implement the strategies
3. Delegate to Management- delegate, monitor and evaluate implementation of strategies by management

Major Duties of Board of Directors

1. Provide continuity for the organization- establish longevity
2. Govern the organization by broad policies and objectives
3. Acquire sufficient resources for the organization's operations- to finance the operations
4. Account to the public for the services of the organization- provide for fiscal accountability, approve the budget and formulate policies

Financial Obligations of the Board

- **Oversee Financial Results**
  - Evaluate results vs. Budget
  - Evaluate results vs. Prior Year to Date
  - Understand Variances

- **Short and Long term financial plan**
  - What is considered short term?
  - What is considered long term?
  - Why long term? Important for capital planning?

Summary

- Various revenue sources surrounding NPSR and how you get paid
- Balance Sheet highlights
- Board Member Responsibilities

Questions and Answers

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