

Introduction

The hospTrends Featured Topic this quarter is a discussion and analysis of hospital performance using our 3 rural hospital categories, Small Town/Isolated Rural, Large Town and Rural Urban Fringe. The Featured Topic is where a financial or utilization category is given a slightly longer explanation. hospTrends reviews the current plus previous 12 quarters, which equals three years plus one quarter. To be consistent we use quarterly data for the entire time period even though actual fiscal year end data is available through 2005. Our web site information and a short description of the data we have available are at the end of the report.

Quarterly Quick Review

Below is a summary table of the statewide trends. The total number of discharges by period has increased between 2.4% and 3.6% for five periods. Between the periods beginning third quarter 2002 and ending fourth quarter 2004 increases were between 0.38% and 1.68%. Patient days have grown more than 1.5% recently. It had a high of 2.6% for the period ending December 31, 2005 and smaller increases the next two periods. Average length of stay decreased to 4.23 and continues what is now a 9 period decrease. Each decrease has been less than 1.7%.

Deductions from revenue grew at a 15.5% rate which, while similar to previous periods, has also been slightly smaller each period since 2003. The operating revenue grew at a slightly higher rate (9.0%) than operating expense (8.5%) which translates into a operating margin increase of 20.8% over the previous period. Operating expense grew by 8.5% which is well within the annual percentage change range of the past 10 years which includes a low of 7.5% and a high of 10.9%. Charity care grew at a relatively sedate 11.2% compared to recent growth of up to 81.2%. Bad debt rebounded slightly from a recent decline with small increases the past two periods of less than 3.3%.

Statewide Summary of Quarterly Reports

	4 Quarter Period Ending		Percent	2006 Percent
	6/30/2005	6/30/2006	Difference	of Tot Rev
Discharges	537,447	552,741	2.8%	
Patient Days	2,302,301	2,337,483	1.5%	
Average Length of Stay	4.28	4.23	-1.3%	
+ Total Revenue	20,176,475,261	22,647,283,179	12.2%	
- Deductions from Revenue	10,397,795,931	12,009,399,339	15.5%	53.0%
= Net Revenue	9,778,679,330	10,637,883,840	8.8%	47.0%
+ Other Operating Revenue	620,597,892	698,254,880	12.5%	3.1%
= Operating Revenue	10,399,277,222	11,336,138,720	9.0%	50.1%
- Operating Expenses	9,989,533,122	10,841,031,535	8.5%	47.9%
= Operating Margin	409,744,100	495,107,185	20.8%	2.2%
+ Other Income/Tax Revenue	126,718,691	146,043,066	15.2%	0.6%
= Total Margin	536,462,791	641,150,251	19.5%	2.8%
Charity Care	472,769,472	525,761,420	11.2%	2.3%
Bad Debt	449,332,983	464,021,164	3.3%	2.0%
Operating Margin	3.94	4.37	10.8%	
Total Margin	5.10	5.58	9.6%	

Featured Topic

A brief explanation of rural hospital categories and utilization and financial information

The Washington State Department of Health Office of Rural Health categorizes hospitals as rural or urban. However there are many methodologies to accomplish this segregation and there is no standard for categorization. The categorization method used in this report separates rural into three categories, Small Town/Isolated Rural, Large Town and Rural Urban Fringe. As you may surmise hospitals in the Small Town/Isolated Rural category are the most distant from other hospitals and urban areas. Hospitals in the Large Town category are in larger towns than those in the Small Town/Isolated Rural category. Hospitals in the Rural Urban Fringe category are those nearest urban areas and yet are still in a rural area. Currently a total of 44 hospitals are in a rural category. Twenty-five hospitals are listed as Small Town/Isolated Rural (25.7%), 14 are listed as Large Town (14.4%) and 5 are listed as Rural Urban Fringe (5.2%). The rest of the hospitals (53) are urban (54.6%). However urban hospitals have 85.1% of the adjusted discharges, while Small Town/Isolated Rural has 4.8%, Large Town has 9.0% and Rural Urban Fringe has 1.0%.

The chart below shows that Small Town/Isolated Rural hospitals as can be expected have a history of just breaking even (having a total margin above zero). A small surprise is that hospitals in the Large Town category are on average as profitable as urban hospitals. This is due to the Large Town hospitals having almost the same ratio of total profit to revenue as Urban Core hospitals except the dollar amounts are much lower. The operating margin per adjusted discharge for Large Town is \$471 while Urban core is \$669. The operating revenue per adjusted discharge for large Town is much smaller, \$7,732 compared to the Urban Core amount of \$11,793.

Total Margin by Rural and Urban category

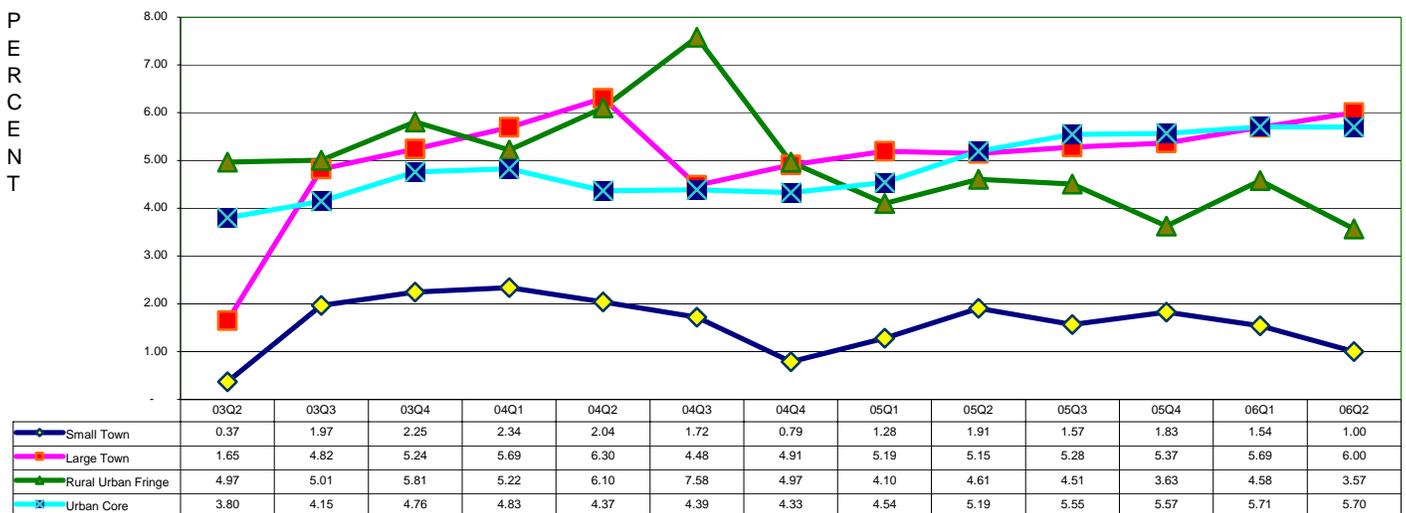


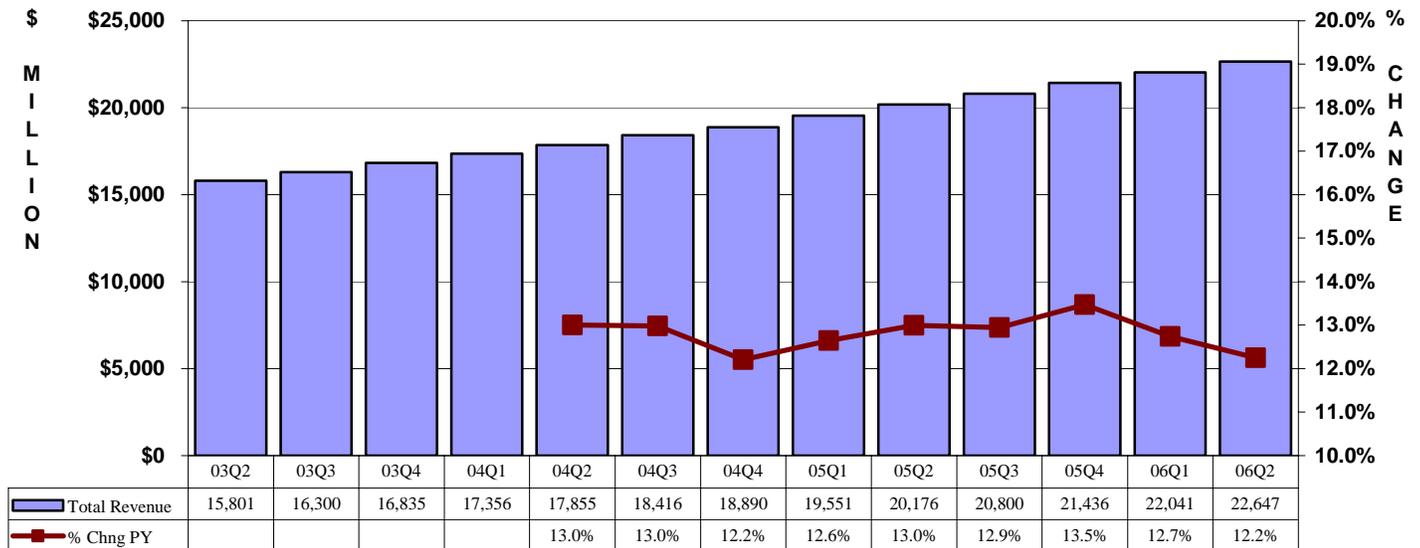
Chart: While the statewide total margin is above 6% recently, hospitals in the Small Town/Isolated Rural and Rural Urban Fringe category are worse than the state average. Small Town/Isolated Rural hospitals have been hovering between zero and 2.0% for many years while Large Town has been doing as well if not better than the urban hospitals.

FINANCIAL INDICATORS

Total Patient Service Revenue

Total billed charges for patient services, which is identified as total patient service revenue or total revenue, increased by \$2.4 billion from \$20.2 billion to \$22.6 billion for the period ending June 30, 2006. The annual increase rate of 12.2% is slightly smaller than recent rates. The annual dollar increase has been between \$2.05 and \$2.55 billion each four quarter year for the past sixteen periods. The billed charges are based on common billing charge sheets that the hospital uses for all patients regardless of the payer and regardless of any contractual adjustments.

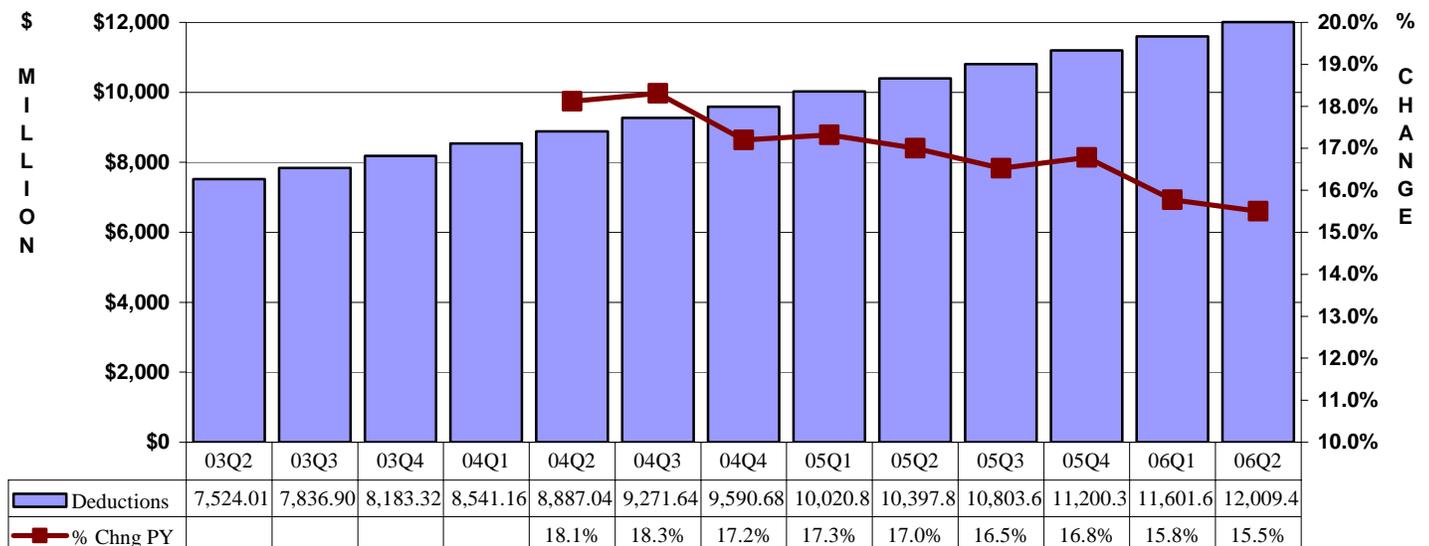
Total Patient Service Revenue



Total Deductions from Revenue

For the twelve months ended June 30, 2006 total deductions from revenue reached \$12.0 billion. This was an increase of \$1.6 billion, or 15.5% over the previous period ending June 30, 2005. Total deductions from revenue have been more than 50% of total patient service revenue since the four quarters ending September 2004. Total deductions have grown between 15.5% and 17.3% the past eight periods and the increases have been getting slightly smaller since the period ending December 31, 2002. Total deductions include contractual adjustments and charity care. Deductions are the difference between what the hospital billed and what they were paid.

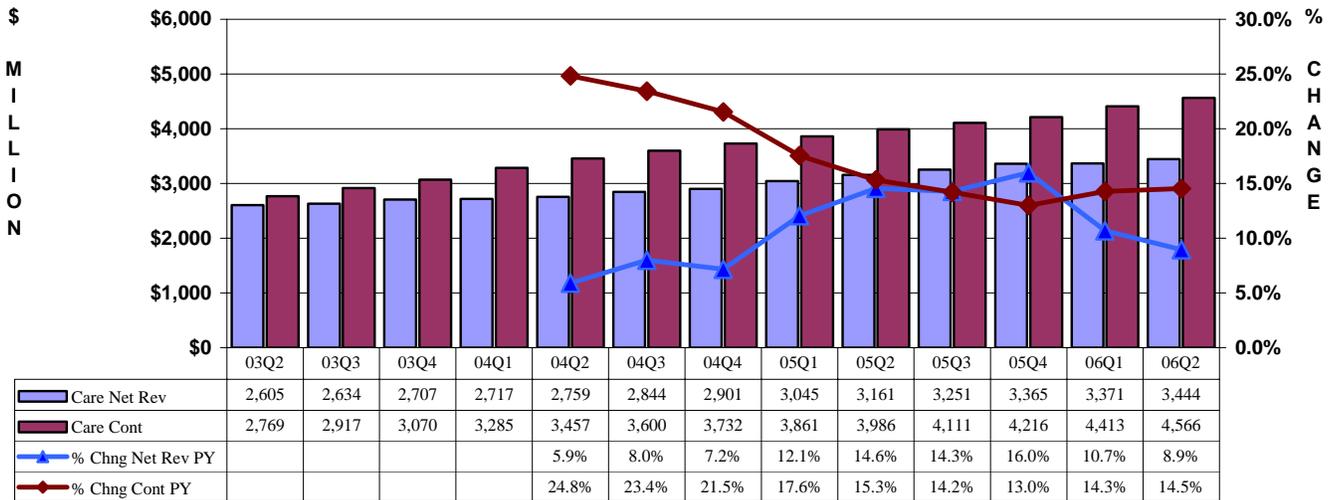
Total Deductions from Revenue



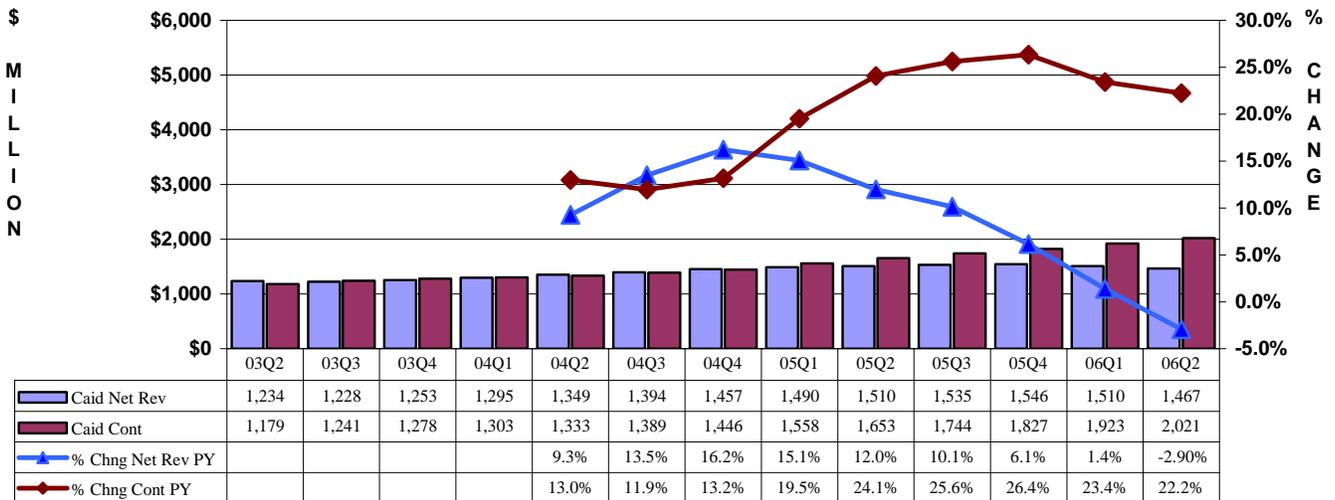
Contractual Adjustments

Contractuals, the most significant part of deductions from revenue, vary by payer. Below are three graphs, one for each payer, Medicare, Medicaid and Other. The three graphs are set up so you can see the relative size of the contractual adjustments and the net revenue by payer. The chart shows net revenue and contractuals and the percentage change for each over the prior year period. Other payer has the largest portion of net revenue, \$6.253 billion and deductions of \$4.897 billion. Medicare's net revenue of \$3.444 billion is much less than Other however the contractuals are similar to Other at \$4.566 billion. Medicaid net revenue was \$1.467 billion and deductions were \$2.021 billion. Based on the hospital's rate sheet, or billed revenue, hospitals bill Medicare an average of \$2.32 for each dollar they receive, Other payers an average of \$1.78 and Medicaid an average of \$2.37.

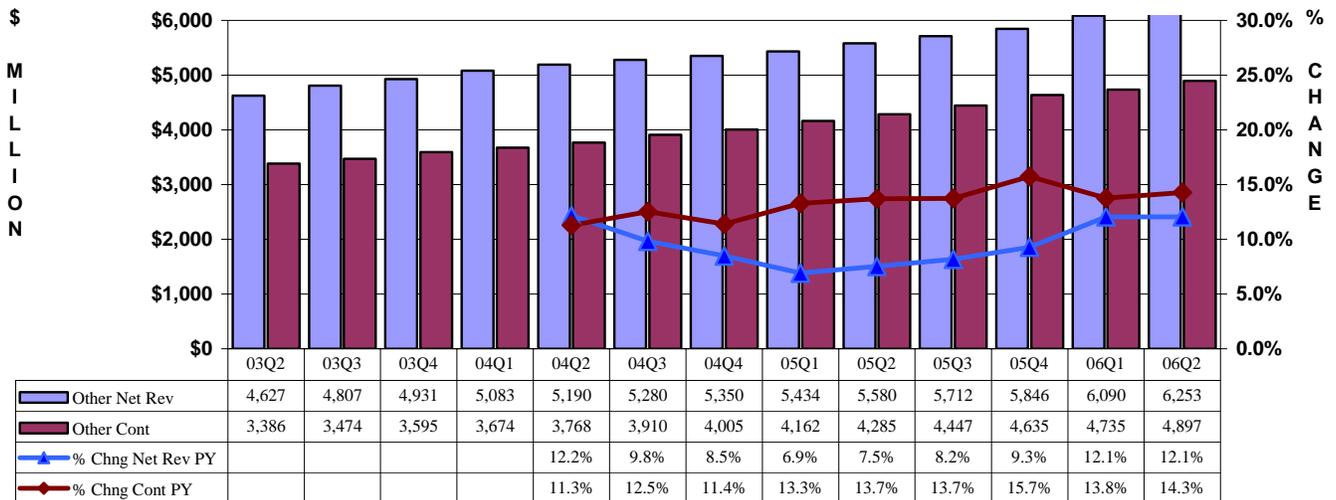
Medicare Contractuals



Medicaid Contractuals



Other Contractuals



Uncompensated Care

Uncompensated care is composed of charity care and bad debt expense. While charity care is part of the deductions from revenue category and bad debt is part of the operating expenses, they are similar. Each represents billed charges for hospital services that are not paid. Charity care represents charges that are not paid by patients who are **unable** to pay, while bad debt expense arises from charges that are not paid by patients who are **unwilling** to pay. During this four quarter cycle, charity care has grown by 11.2% and bad debt has increased by 3.3%, for a total increase in uncompensated care of 7.3%.

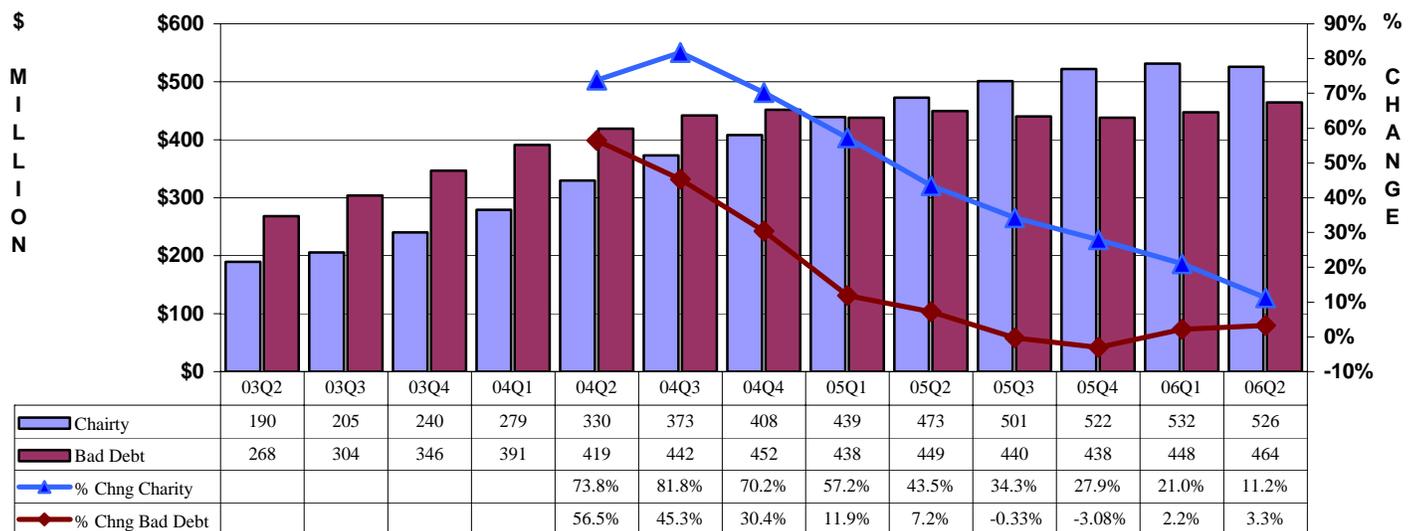
Charity

While charity care is only 2.32% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. Recently, during the June 30, 2005 to June 30, 2006 period, charity care has increased 11.2% or \$53.0 million. Even though the increase was sizable, it is the smallest increase in several years.

Bad Debt

The bad debt dollar amount has grown from \$449 million for the four quarters ending June 30, 2005 to \$464 million for the period ending June 30, 2006 which is a 3.3% increase. This marks only the second period increase since a two period decrease ending December 31, 2005 at \$438 million. Bad debt total dollars have been less than those of charity care since the period ending March 31, 2005. Prior to that time bad debt always was a larger dollar amount.

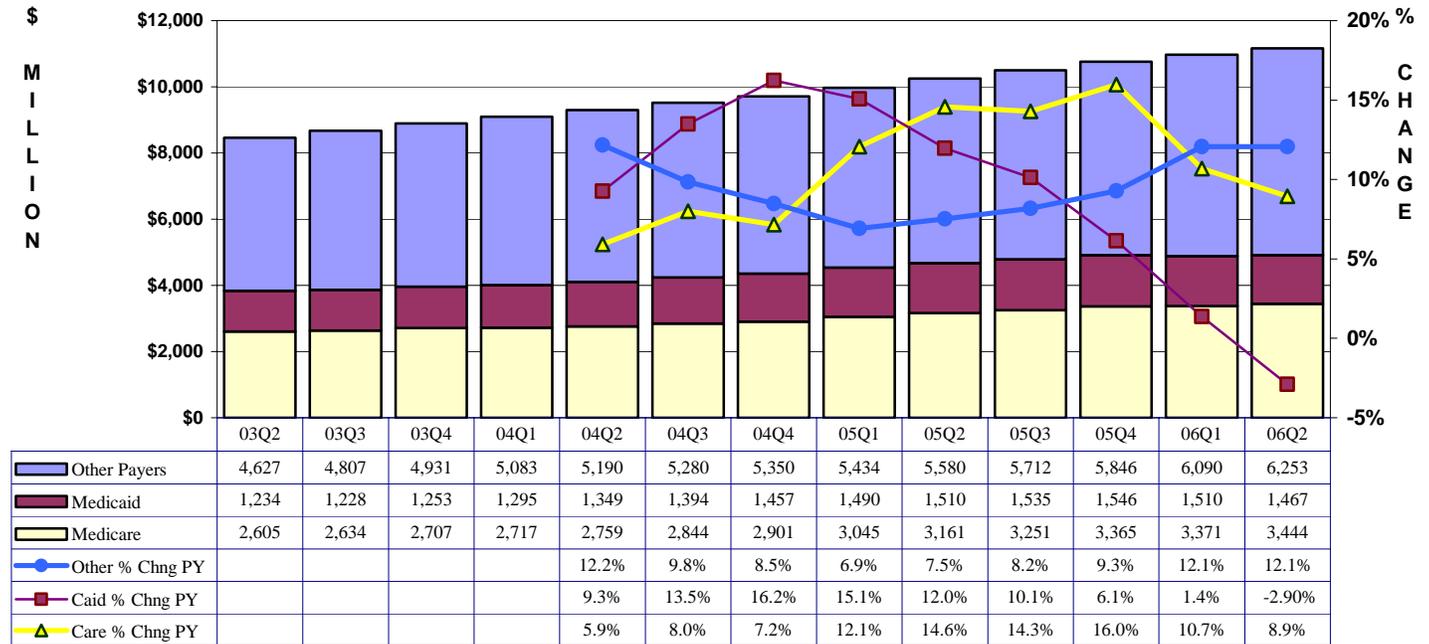
Charity and Bad Debt



Net Patient Services Revenue

During the twelve month period ended June 30, 2006 net patient service revenue grew by 8.8%, or \$859 million, from \$9.8 billion to \$10.6 billion. Other payer continues its strong percentage and dollar growth (12.1%, \$673 million). Medicare payer not only had a smaller percentage increase than Other but its increases have been getting smaller since the quarter ending December 31, 2005. The percentage change by payer from the previous year period shows that Medicare had a 8.9% increase and Other had a 12.1% increase over the twelve month period ending June 30, 2005. Because Medicaid revenue only increased 10.2% while Medicaid deductions increased by 22.2%, the net patient service revenue for Medicaid actually decreased by 2.9% from the previous period.

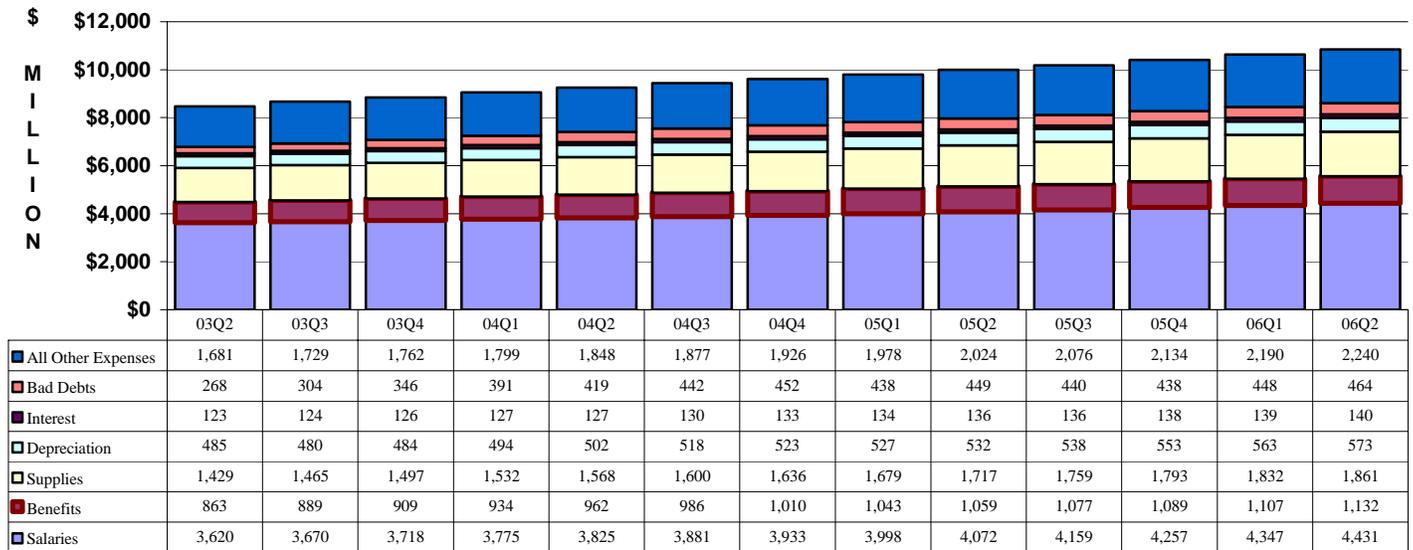
Net Patient Service Revenue by Payer



Operating Expenses

Operating expenses are the costs of providing health care services to hospital patients. Growing by 8.5%, or \$851 million, operating expenses reached \$10.8 billion in the twelve month period ended June 30, 2006. Adjusted discharges only increased 3.6% during the same time period. Operating expenses per adjusted discharge increased by 4.7%. The 4.7% increase exceeded the 4.3% annual increase in the overall consumer price index and the 4.1% annual increase in the hospital services component of the index for the same time period of June 2005 to June 2006. Because of the increase of fuel costs, the overall consumer price index rose more than the hospital index. The hospital price index is normally higher than the overall consumer price index. CPI information is at this link <ftp://ftp.bls.gov/pub/news.release/History/cpi.07192006.news>. The category with the largest dollar increase in operating expenses was salaries at 8.8% or \$359 million for a total of \$4,431 million. The category with the largest percentage increase in operating expenses was all other expenses at 10.7%, or \$215 million for a total of \$2,240 million. Interest expense and bad debt expense again had the smallest dollar and percentage increase respectively during the same period.

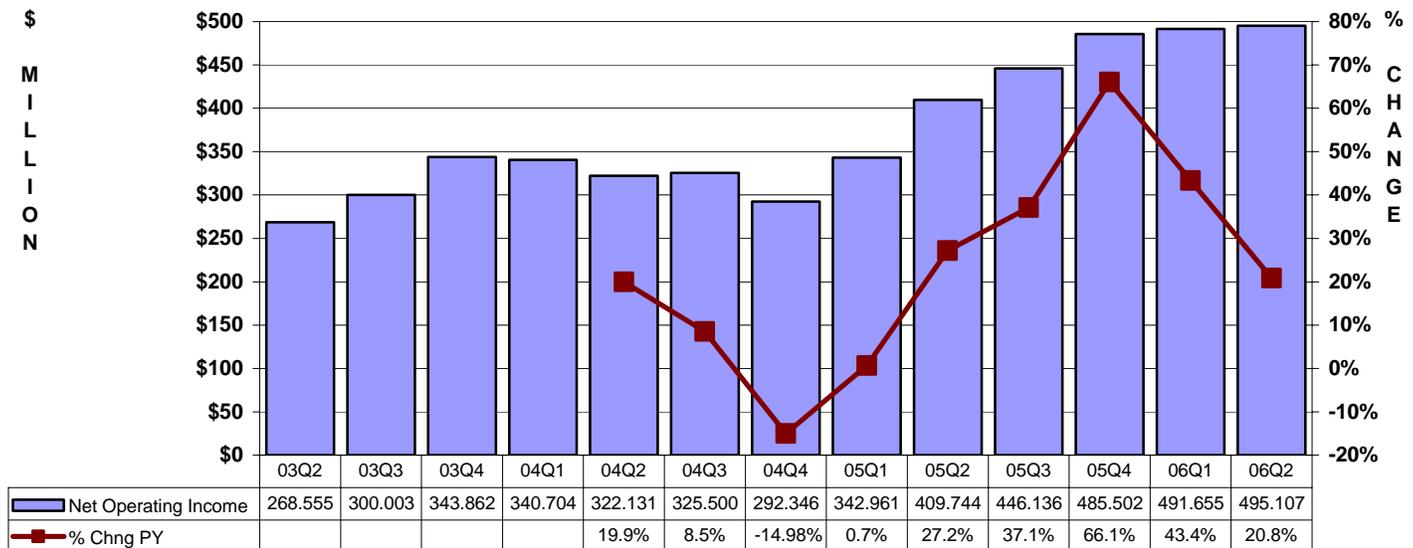
Operating Expense



Net Operating Income

During the four quarters ended June 30, 2006 net operating income advanced to \$495 million, which was up 20.8% over the year ago level. Net operating income is volatile due to the large dollars that are involved in the calculation. A small change in the ratio of operating income, which grew 9.1% and operating expense, which grew 8.5%, caused the 20.8% change in net operating income. Net operating income includes other operating income.

Net Operating Income

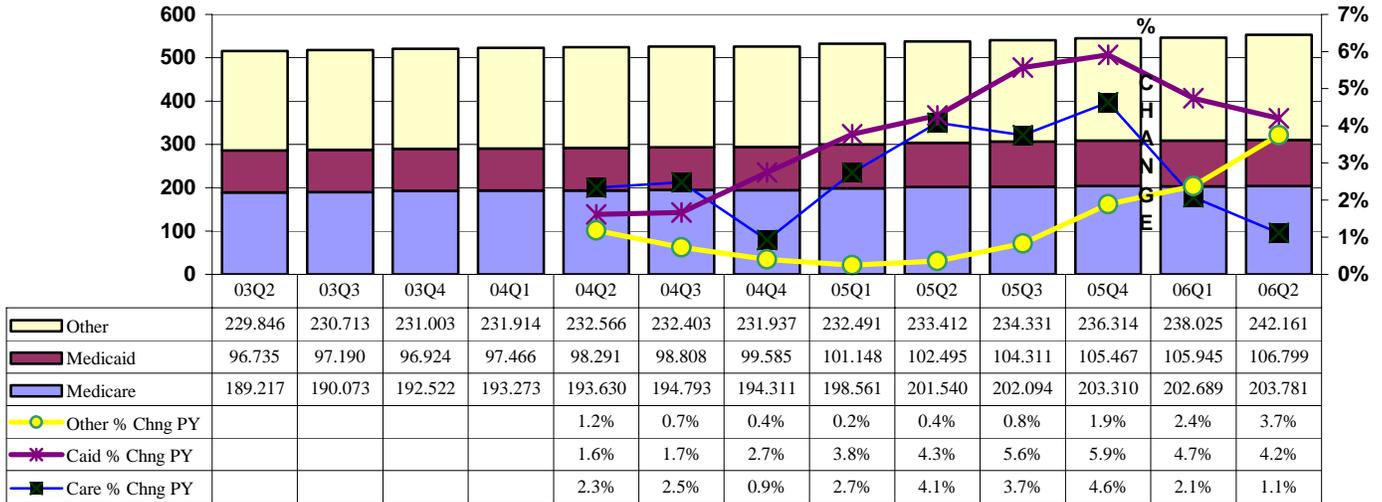


UTILIZATION INDICATORS

Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow, reaching a total of 552,741 discharges during the four quarters ending June 30, 2006. This was a gain of 15,294 discharges, or 2.85%, over the corresponding 2005 period. Medicaid had significantly larger growth percent than Other and slightly more than Medicare.

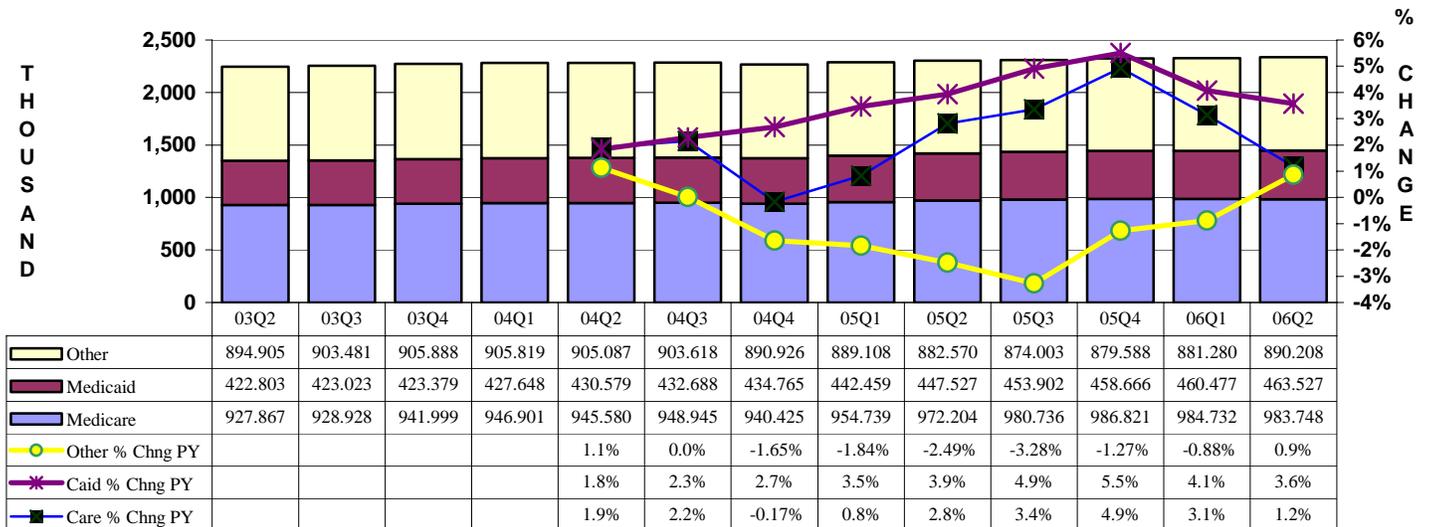
Discharges by Payer



Patient Days

Patient days also continued to grow, reaching a total of 2,337,483 during the four quarters ending June 30, 2006. This was a gain of 35,182 patient days, or 1.53%, over the corresponding year ago period. Medicare days grew 1.2%, Medicaid days grew 3.6% and Other increased by .9%.

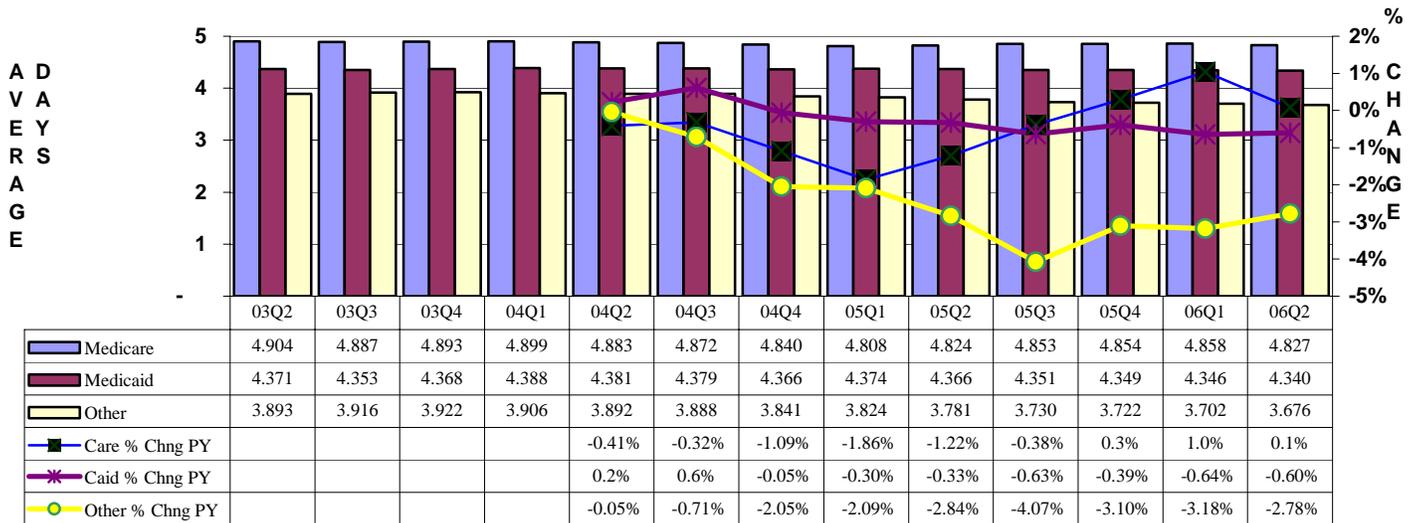
Patient Days by Payer



Length of Stay

Since the percentage increase in statewide discharges during the four quarters ending June 30, 2006 exceeded the increase of patient days, statewide average length of stay declined slightly to 4.23 days, or 1.3%. Statewide average length of stay (ALOS) had remained in the range of 4.37 days to 4.24 days from calendar year 1995 through 2006 second quarter. During the four quarters ended June 30, 2006 the average length of stay has declined by .04 days from the previous period ending June 30, 2005. In the latest period, Medicare average length of stay was 4.83, Medicaid was 4.34 and Other was 3.68. Medicare ALOS was 11.2% higher than Medicaid and 31.3% higher than Other payer.

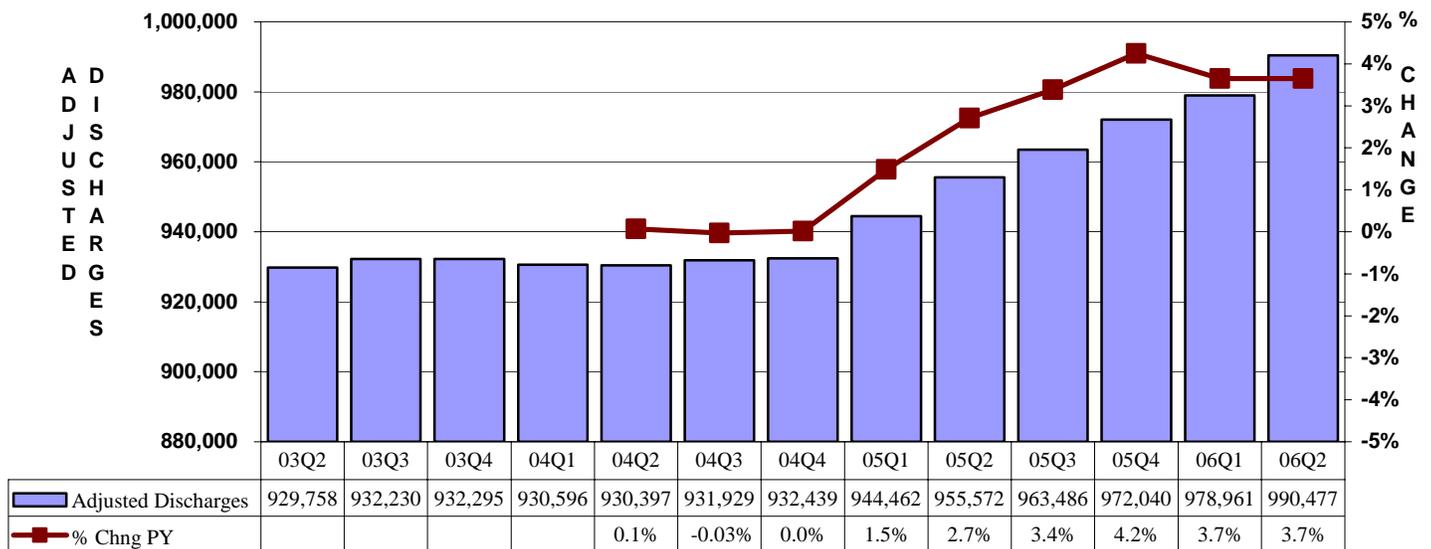
Length of Stay by Payer



Adjusted Discharges

Adjusted discharges reached a total of 990,477 in the four quarter period ended June 30, 2006. This was an increase of 34,904 adjusted discharges, or 3.6%, from the four quarter period ended June 30, 2005. The percentage increase was down slightly from the largest one year increase in adjusted discharges in over 10 years for the calendar year 2005 over the calendar year 2004. Adjusted discharges were created as a proxy for total hospital volume since discharges only count inpatients. Adjusted discharges, within the quarterly system, are calculated by increasing discharges by the percent of inpatient revenue to total revenue.

Adjusted Discharges

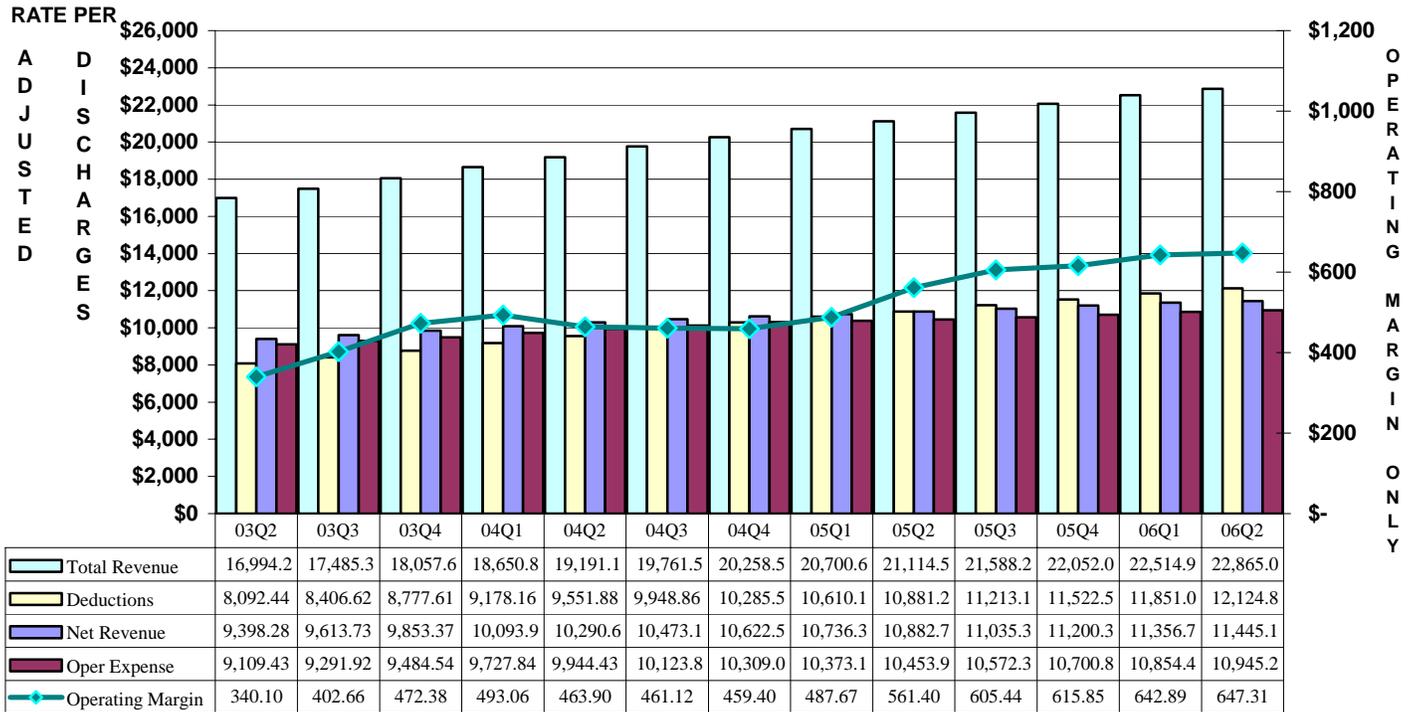


OPERATING INDICATORS

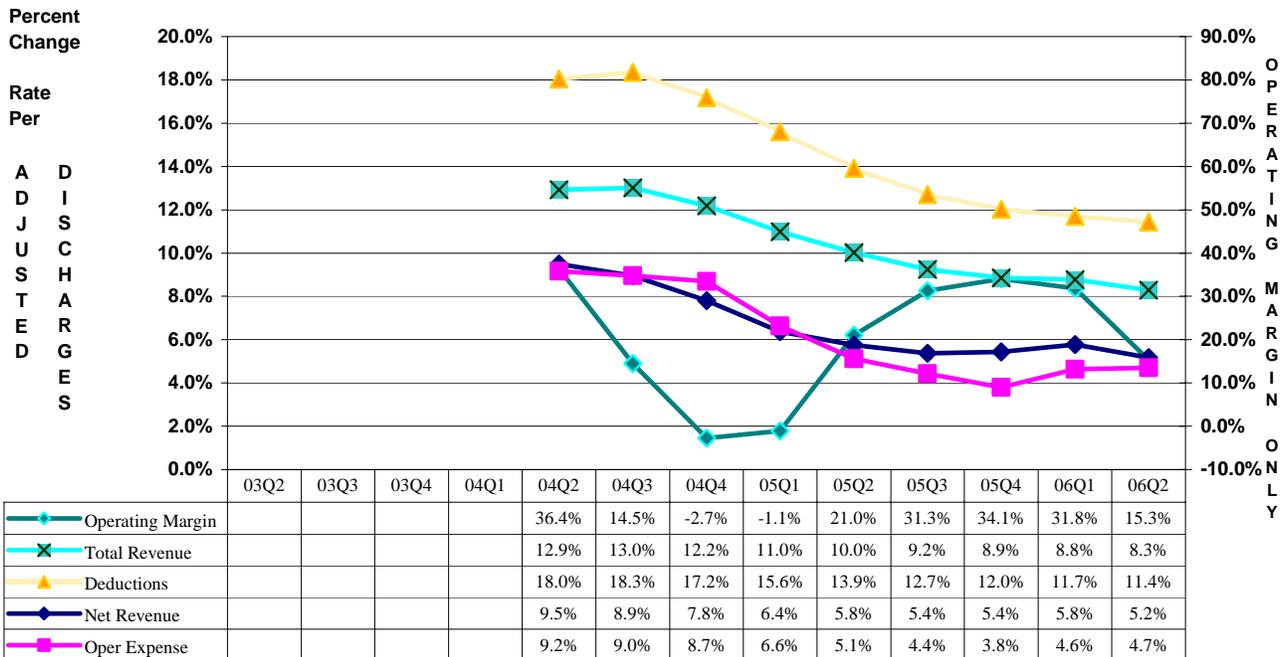
Rates per Adjusted Discharge

When you take the total dollar amounts for various categories and divide by the adjusted discharge count, you get an average rate per adjusted discharge. This formula removes volume fluctuation from the review and makes it easier to look at other factors. While the dollar amount of rates continues to rise each period, the percentage increase is on a slight downward swing, except for net profit which is currently on a rise. Note the continued large increase of deductions as it becomes a bigger number than net revenue. Total or billed revenue is becoming less relevant each year as it is now more than twice the actual dollar amount collected.

Rate per Adjusted Discharge



Percent Change - Rate per Adjusted Discharge



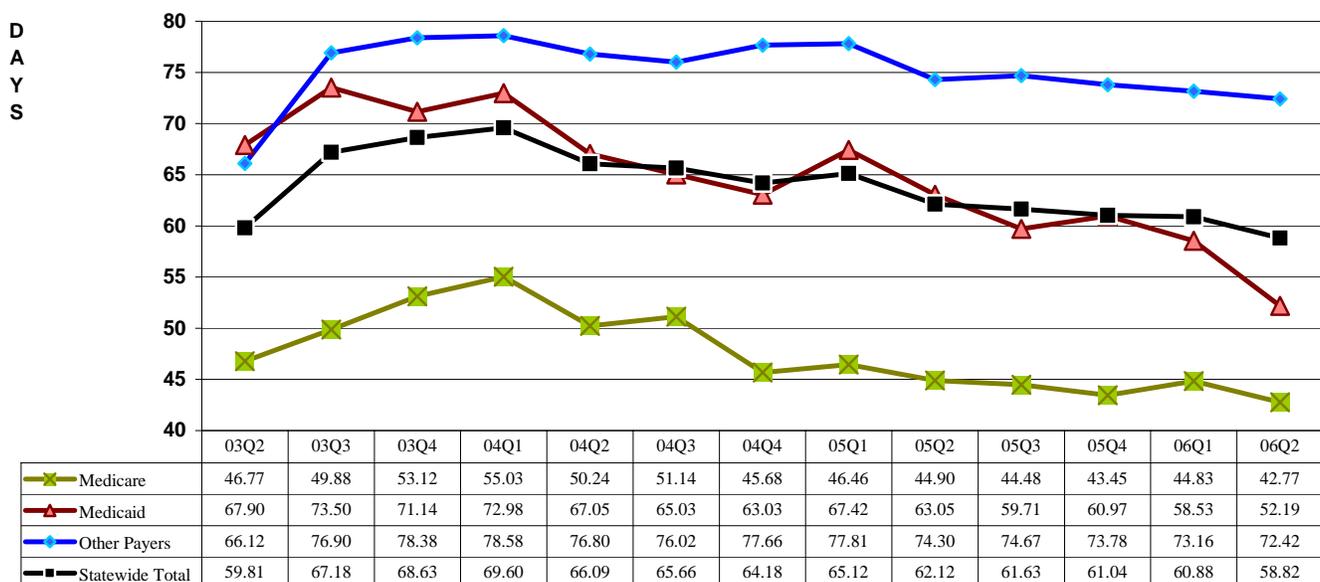
FINANCIAL RATIOS

The relationships between financial indicators are reflected by financial ratios. The financial ratios selected for this report are not all encompassing, but represent financial indicators that can be readily calculated from the data available through the quarterly reporting process as currently designed without requesting supplemental data from the reporting hospitals.

Days in Accounts Receivable

Accounts receivable is the largest item in the current assets portion of the balance sheet for most hospitals. Days in accounts receivable is a measure of how “current” this asset is. In this report days in accounts receivable is calculated on an annual gross basis. Shorter days or smaller numbers are more desirable. On a statewide basis, accounts receivable averaged 58.8 days for the four quarter period ending June 30, 2006. This was a reduction of 3.3 days, or 5.3%, from the corresponding year earlier period. Medicare accounts receivable decreased by 2.1 days, or 4.7%, to 42.8 days. Accounts receivable for Medicaid dropped by 10.9 days, or 17.2%, to 52.2 days. A reduction of 1.9 days, or 2.5%, to an average of 72.4 days was also noted for the Other payer groups.

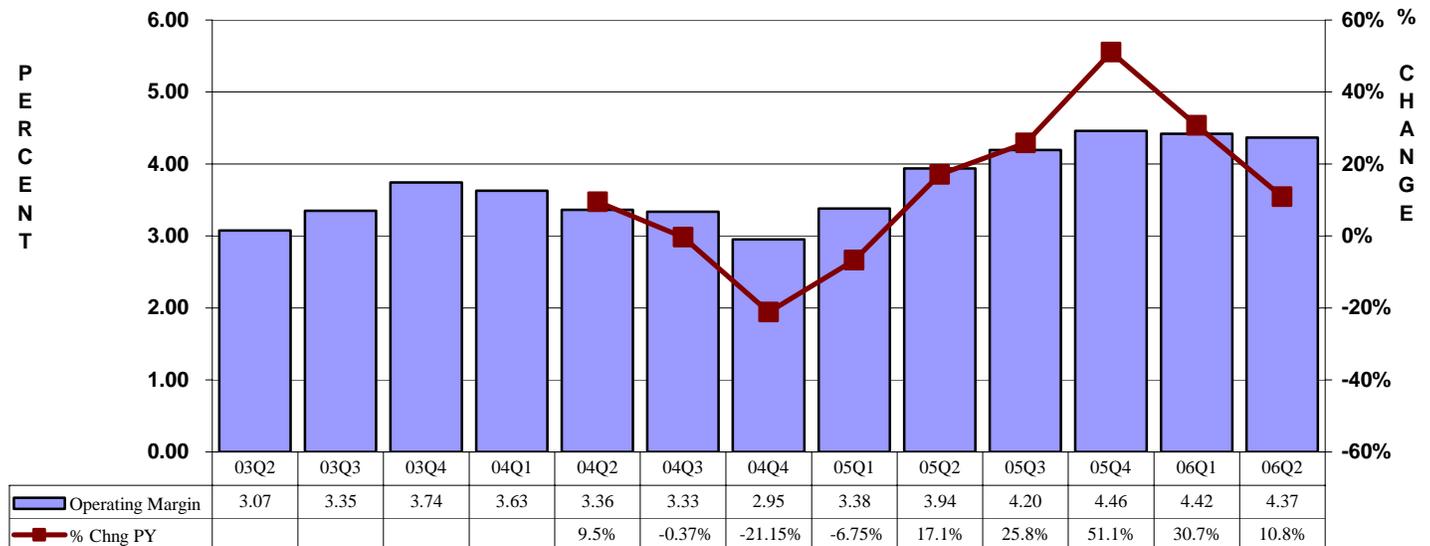
Days in Accounts Receivable by Payer



Operating Margin

During the twelve month period ended June 30, 2006 operating margin reached 4.37%, which was 10.9% above the year earlier level. The current period is slightly below the recent high level of 4.46 which is from the four quarters ending December 31, 2005. The low was 1.4% for the four quarters ending December 31, 2000. Operating margin includes patient revenue and other operating revenue.

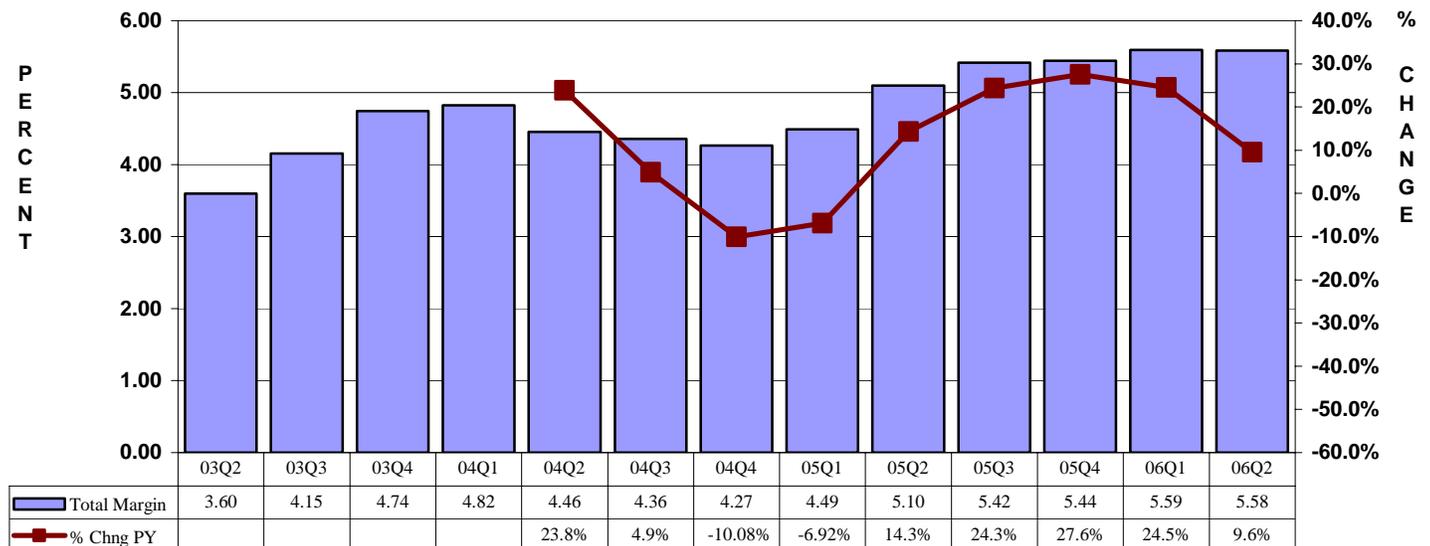
Operating Margin



Total Margin

During the twelve month period ending June 30, 2006 operating margin reached 5.58%, which was 9.6% above the year earlier level. The recent low of 1.9% was for the year 2000. Total margin includes operating margin plus extraordinary items, federal income taxes and non operating income.

Total Margin



Deductible Proportion

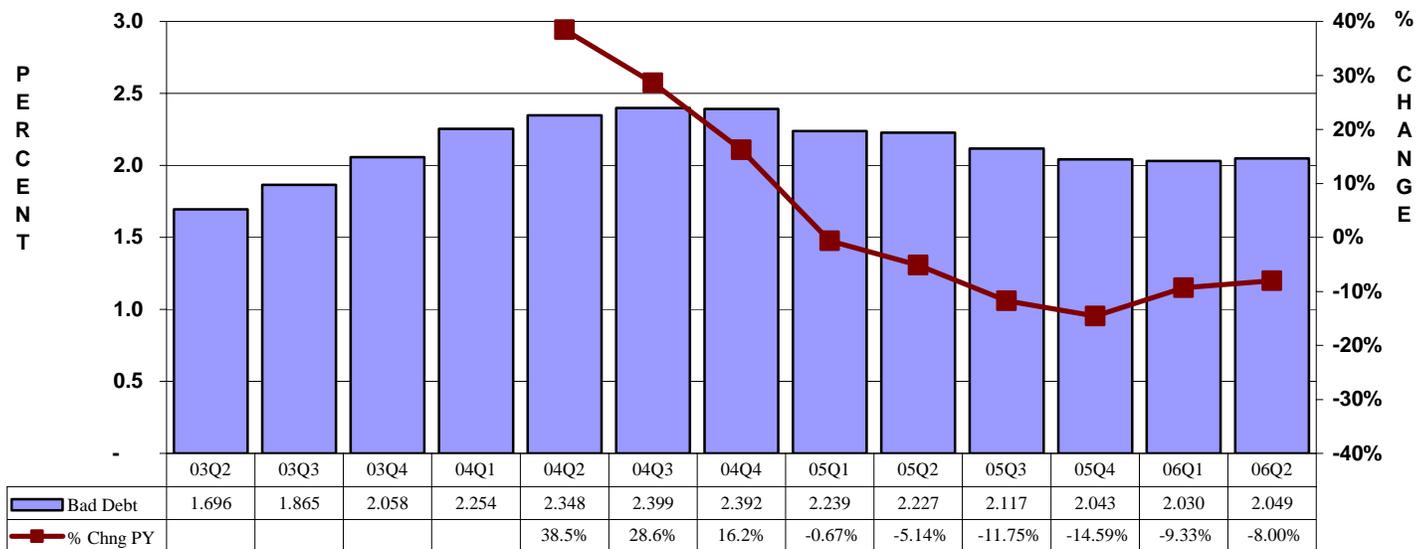
Uncompensated Care Proportion

The bad debt proportion, charity proportion, and total uncompensated care proportion, compare bad debt expense, charity care, and total uncompensated care to total patient service revenue. The total uncompensated care proportion reached 4.37%, which was a decline of .20% over the previous year because bad debt had a very small actual dollar increase.

Bad Debt

In the four quarter period ended June 30, 2006, the bad debt proportion reached 2.05%, which was a decrease of 8.0% from the previous year. This continued a decline in this ratio of six periods in a row.

Bad Debt as a Percent of Total Revenue



Charity Care

The charity care proportion reached 2.32%, which was a decrease of .92% over the previous year. While it was a slight decline from the previous period, it was the first since the period ending September 30, 2003.

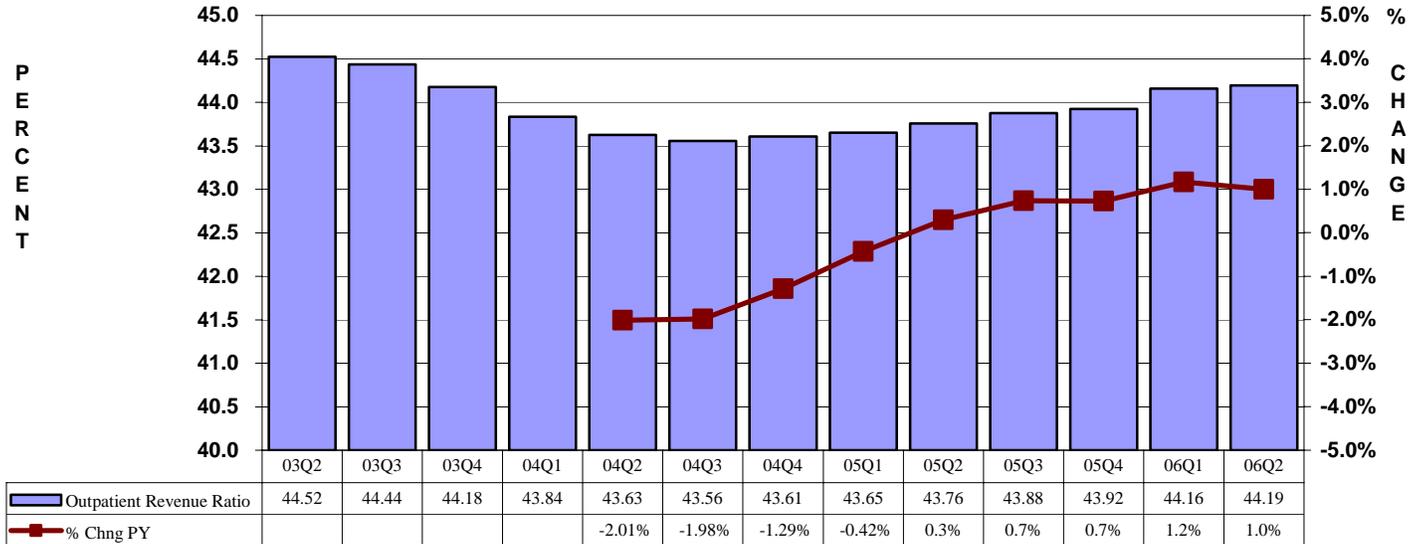
Charity Care as a Percent of Total Revenue



Inpatient and Outpatient Revenue

The outpatient revenue percentage is a way of looking at the relationship between inpatient and outpatient revenue. It is a rough indicator of the change in treatment locations. Between the annual periods ended June 30, 2005 and June 30, 2006 the outpatient revenue percentage increased from 43.8% to 44.2%, or 1.0%. As hospitals moved procedures from inpatient to outpatient setting over the years, the ratio has gone up dramatically. In 1987 the ratio was 24.2%. Recently the ratio has been between 43 and 45.

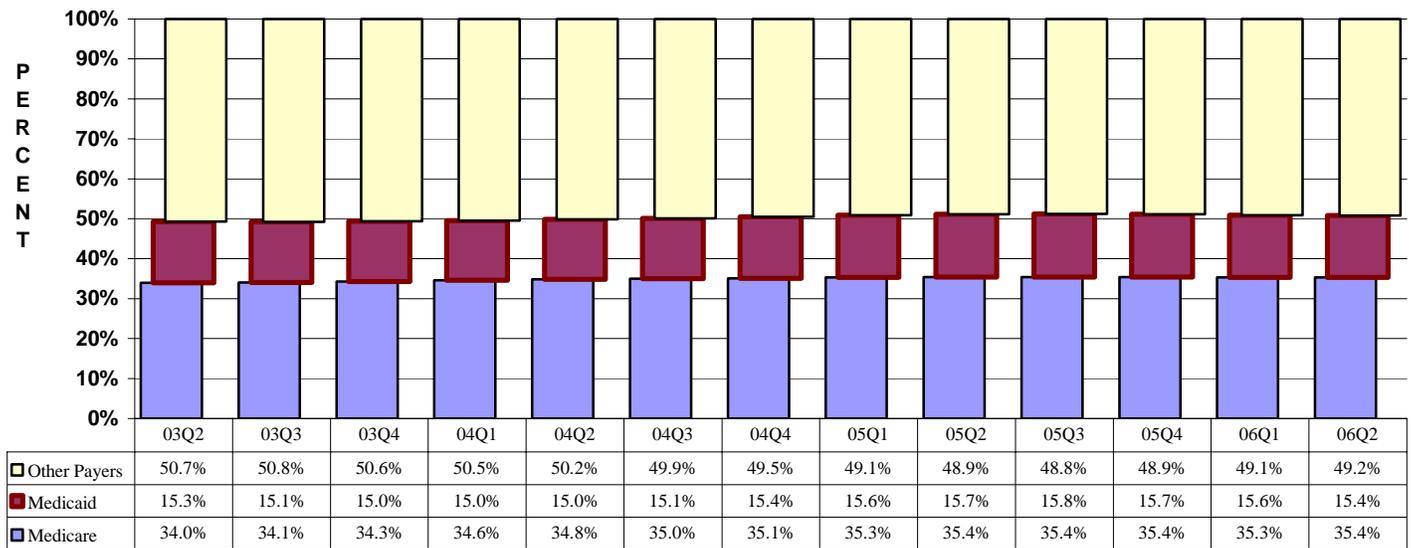
Outpatient Revenue as a percent of Total Revenue



Medicare, Medicaid and Other Revenue

The Medicare billed revenue percentage and the Medicaid billed revenue percentage indicate the proportion of total hospital business that these programs represent. In the four quarter period ended June 30, 2006 the Medicare percentage was 35.4%, an increase of 0.1% over the same period in 2005. The long term trend it seems is that Medicaid is relatively steady around 15.5% while Other seems to be slowly losing percentage points to Medicare. With 50.8% of total patient service revenue, the Medicare and Medicaid programs have a major influence on the financial health of hospitals.

Revenue proportion by Payer



HOSPITAL PERFORMANCE STATEWIDE	12 Mo. Ended Jun 30 2005	12 Mo. Ended Jun 30 2006	Total Change	Percent Change
Total Patient Revenue				
Inpatient	11,347,949,954	12,638,442,566	1,290,492,612	11.37%
Outpatient	8,828,525,307	10,008,840,613	1,180,315,306	13.37%
Total	20,176,475,261	22,647,283,179	2,470,807,918	12.25%
Medicare	7,147,377,877	8,009,435,681	862,057,804	12.06%
Medicaid	3,163,643,220	3,487,271,117	323,627,897	10.23%
Other	9,865,454,164	11,150,576,381	1,285,122,217	13.03%
Deductions From Revenue				
Contractual Adjustments				
Medicare	3,986,460,982	4,565,834,992	579,374,010	14.53%
Medicaid	1,653,241,399	2,020,721,121	367,479,722	22.23%
Other	4,285,324,078	4,897,081,806	611,757,728	14.28%
Total	9,925,026,459	11,483,637,919	1,558,611,460	15.70%
Charity	472,769,472	525,761,420	52,991,948	11.21%
Total	10,397,795,931	12,009,399,339	1,611,603,408	15.50%
Uncompensated Care				
Bad Debt	449,332,983	464,021,164	14,688,181	3.27%
Charity	472,769,472	525,761,420	52,991,948	11.21%
Total	922,102,455	989,782,584	67,680,129	7.34%
Net Patient Revenue				
Medicare	3,160,916,895	3,443,600,689	282,683,794	8.94%
Medicaid	1,510,401,821	1,466,549,996	(43,851,825)	-2.90%
Other	5,580,130,086	6,253,494,575	673,364,489	12.07%
Total	9,778,679,330	10,637,883,840	859,204,510	8.79%
Other Operating Revenue	620,597,892	698,254,880	77,656,988	12.51%
Total Operating Revenue	10,399,277,222	11,336,138,720	936,861,498	9.01%
Total Operating Expenses	9,989,533,122	10,841,031,535	851,498,413	8.52%
Net Operating Income	409,744,100	495,107,185	85,363,085	20.83%
Non-Operating Income	110,075,845	120,611,041	10,535,196	9.57%
Tax Revenue	16,642,846	25,432,025	8,789,179	52.81%
Net Total Income	536,462,791	641,150,251	104,687,460	19.51%
Gross Accounts Receivable				
Medicare	879,184,543	938,468,339	59,283,796	6.74%
Medicaid	546,520,153	498,611,858	(47,908,295)	-8.77%
Other	2,008,262,497	2,212,464,431	204,201,934	10.17%
Total	3,433,967,193	3,649,544,628	215,577,435	6.28%
Days in Accounts Receivable				
Medicare	44.9	42.8	(2.1)	-4.75%
Medicaid	63.1	52.2	(10.9)	-17.23%
Other Payers	74.3	72.4	(1.9)	-2.53%
Statewide Total	62.1	58.8	(3.3)	-5.32%
Utilization				
Discharges	537,447	552,741	15,294	2.85%
Patient Days	2,302,301	2,337,483	35,182	1.53%
Length of Stay	4.28	4.23	(0.05)	-1.28%
Adjusted Discharges	955,572	990,477	34,904	3.65%
Rates per Adjusted Discharge				
Total Revenue	21,114.55	22,865.04	1,750.49	8.29%
Deductions	10,881.22	12,124.87	1,243.64	11.43%
Net Revenue	10,882.77	11,445.14	562.36	5.17%
Operating Expense	10,453.98	10,945.27	491.29	4.70%
Net Margin	561.40	647.31	85.91	15.30%
Financial Ratios				
Operating Margin	3.94	4.37	0.43	10.85%
Total Margin	5.10	5.58	0.49	9.56%
Deductible Proportion	51.53	53.03	1.49	2.90%
Contractual Proportion - Total	49.19	50.71	1.52	3.08%
Contractual Proportion - Medicare	55.78	57.01	1.23	2.21%
Contractual Proportion - Medicaid	52.26	57.95	5.69	10.88%
Contractual Proportion - Other	43.44	43.92	0.48	1.11%
Bad Debt Proportion	2.23	2.05	(0.18)	-8.00%
Charity Proportion	2.34	2.32	(0.02)	-0.92%
Uncompensated Care Proportion	4.57	4.37	(0.20)	-4.37%
Total Revenue/Inpatient Revenue	1.78	1.79	0.01	0.78%
Outpatient Revenue Percent	43.76	44.19	0.44	1.00%
Medicare Revenue Percent	35.42	35.37	(0.06)	-0.16%
Medicaid Revenue Percent	15.68	15.40	(0.28)	-1.80%

Notes:

Information

For more detailed information you can visit the Department of Health - Hospital and Patient Data web site at <http://www.doh.wa.gov/EHSPHL/hospdata> for a large variety of hospital data and reports. Included are hospital financial data and reports, hospital discharge data and reports, and Charity Care reports. Also included are Directory of Hospitals, CHARS Procedure Manual, *Accounting and Reporting Manual for Hospitals*, Charity Care reports and past *hospTRENDS*.

Your comments and suggestions for improvement would be greatly appreciated. Please let us know what you like or don't like about the content and presentation of the *hospTRENDS* report. Contact information is on the last page.

Background

All licensed hospitals in the State of Washington submit summary financial and utilization data to the Department of Health following each calendar quarter. Reported data are edited, summarized, and analyzed by Hospital and Patient Data Systems staff. Specific data elements are defined in the Department's *Accounting and Reporting Manual for Hospitals*. Utilizing these data, various financial and utilization rates and ratios are calculated to enhance the description of the financial condition of hospitals in the state. The purpose of this series of reports is to provide information describing emerging hospital utilization and financial trends to all concerned parties.

Rather than focusing on individual calendar quarters, the data in this report are aggregated into twelve month periods consisting of four calendar quarters each. This aggregation reduces the impact of seasonal fluctuations, which could distort actual trends occurring within the hospital industry.

The period covered by this report includes the last two quarters of 2005 and the first two quarters of 2006. However, this preview is subject to change. The quarterly reports submitted by hospitals contain interim data which have not yet been subjected to audit review. Future adjustments and/or revisions as a result of both the hospital's internal accounting system review and the formal procedures of outside auditors may result in changes to previously submitted data. These future revisions will be reflected in the hospital's year-end reports. The year-end reports not only reflect audit adjustments but also provide substantially greater detail, which allows analysis of the information provided in-- greater depth.

hospTRENDS

Washington State

Community Hospital Financial and Utilization Trend Newsletter

Quarter Ended June 30, 2006

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