

Introduction

The hospTrends Featured Topic this quarter is a discussion and analysis of inflation-adjusted revenues and expenses. 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 2006. 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 had increased between 2.72% and 3.31% 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 only .63% recently. It had a high of 3.66% for the period ending December 31, 2005 and smaller increases the next two periods. Average length of stay increased to 4.30 and continues what is now a 4 period increase

Deductions from revenue grew at an 18.1% rate, the third period of increase, whereas deductions had been slightly smaller each period from 2003 until the fourth quarter of 2006. The operating revenue grew at the same rate (7.9%) as operating expense (7.9%) which translates into an operating margin increase of 6.8% over the previous period. Operating expense grew by 7.9% 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 5.7% compared to recent growth of up to 81.2%. Bad debt surged from recent small increases the past two periods to 23.8%.

Statewide Summary of Quarterly Reports

	4 Quarter Period Ending		Percent	2007
	06/30/2006	06/30/2007	Difference	Percent of Tot Rev
Discharges	553,600	557,079	0.6%	
Patient Days	2,340,015	2,392,946	2.3%	
Average Length of Stay	4.23	4.30	1.6%	
+ Total Revenue	22,690,199,745	25,724,849,529	13.4%	
- Deductions from Revenue	12,025,268,017	14,203,540,750	18.1%	55.2%
= Net Revenue	10,664,931,728	11,521,308,779	8.0%	44.8%
+ Other Operating Revenue	699,160,506	735,565,922	5.2%	2.9%
= Operating Revenue	11,364,092,234	12,256,874,701	7.9%	47.6%
- Operating Expenses	10,870,505,185	11,729,477,561	7.9%	45.6%
= Operating Margin	493,587,049	527,397,140	6.8%	2.1%
+ Other Income/Tax Revenue	147,678,968	248,025,369	67.9%	1.0%
= Total Margin	641,266,017	775,422,509	20.9%	3.0%
Charity Care	526,521,154	556,794,149	5.7%	2.2%
Bad Debt	465,741,512	576,428,850	23.8%	2.2%
Operating Margin	4.32	4.28	-1.0%	
Total Margin	5.55	6.18	11.3%	

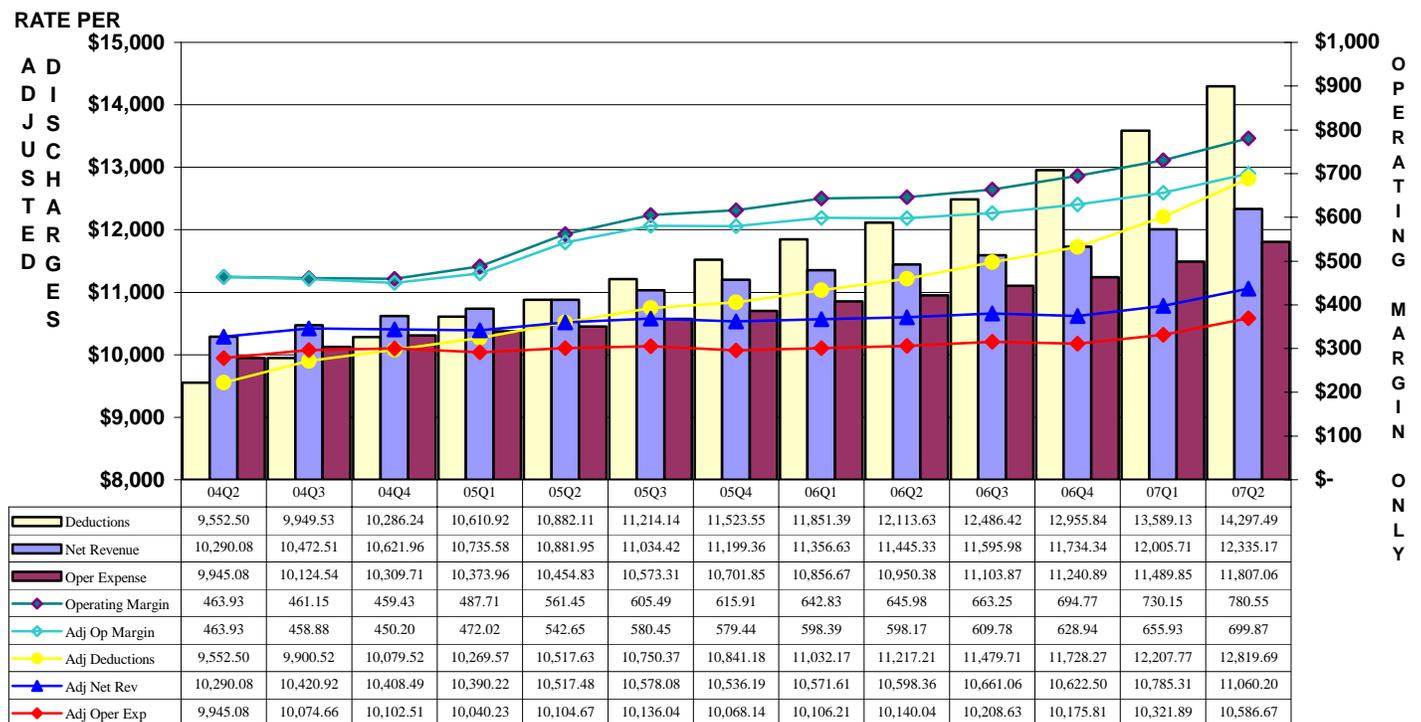
Featured Topic

Inflation-adjusted revenues and expenses

The quarterly database collects data in actual dollars. Looking at the changes in financial values over time in actual dollars is essential, but the real value of those dollars changes over time. This means that an analyst or researcher can't really compare like figures from two different time periods and make meaningful conclusions without understanding the relative value of the dollars at the two different points in time. In order to compare those values, we can use tools like price deflators, which measure the change in the value of dollars over time. Using these deflators, we can adjust values to match a base year; so that \$100 in 2007 now has the same value that \$100 did in 2004. By doing this, we can see whether costs (or any other financial variables) have really changed over time.

The federal government publishes several different price deflators, each of which has a slightly different purpose. The deflator with which most people are familiar is the Consumer Price Index or CPI. The CPI measures the changing price of a representative "market basket" of goods and services purchased by a typical consumer. This is a good way to compare the relative cost of day-to-day life for US consumers. The government also produces industry-specific Producer Price Indices, or PPIs. These measure the changes in price over time received by firms in a specific industry. In this month's report, we have adjusted values by the PPI specific to general and surgical hospitals, published by the federal Bureau of Labor Statistics.

Deductions, Revenue, and Expense



The table above displays the un-adjusted, or nominal, values for deductions, net revenue, operating expense, and operating margin per adjusted discharge in Washington hospitals from the twelve months ending June 30, 2004, through the twelve months ending June 30, 2007. These values are represented by the vertical bars and the solid green line. The table also displays the deflated versions of these values, represented by the lines in colors that generally match the color of their corresponding unadjusted values.

By comparing the adjusted and unadjusted values we can see, for example, that while net revenue per adjusted discharge has increased from \$10,290 in June 2004 to \$12,335 in June 2007, inflation adjusting tells us that the 2007 figure was the equivalent of \$11,060. In other words, the dollar amount increased \$2,045, but that translates to just \$770 in 2004 dollars.

An examination of the inflation-adjusted values for net revenue and operating expense shows us that the two values have remained remarkably stable over the past 12 quarters, with a recent up-tick in 2007. Inflation adjusting also shows us that, even accounting for inflation, deductions have increased dramatically in the past

three years, and appear to be accelerating. Finally, the chart below tells us that the recent increase in operating margin hasn't just been an artifact of inflation – the adjusted values show an increase of \$235.94 per adjusted discharge – slightly more than a 50% increase.

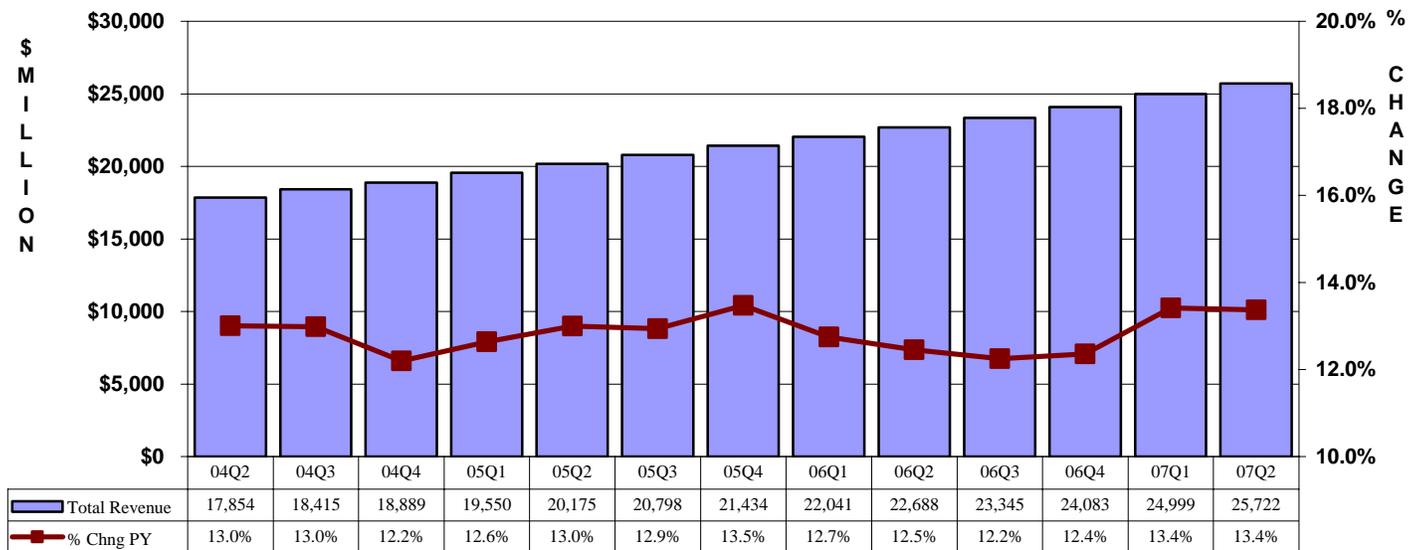
In conclusion, while the world operates in nominal dollars, they don't always tell the whole story. Increased costs always “feel” real, but inflation adjusting can sometimes give us a better feel for what is “really” happening in our financial data.

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 \$3 billion from \$22.7 billion to \$25.7 billion for the period ending June 30, 2007. The annual increase rate of 13% is slightly higher 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.

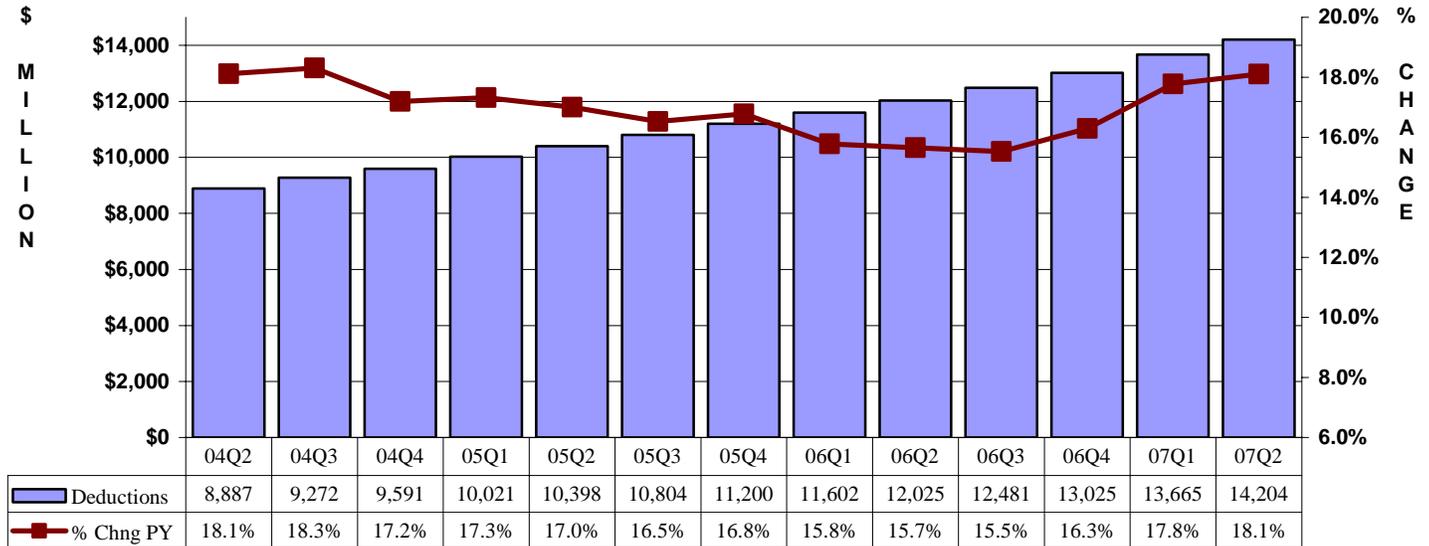
Total Patient Service Revenue



Total Deductions from Revenue

For the twelve months ended June 30, 2007 total deductions from revenue reached \$14.2 billion. This was an increase of \$2.1 billion, or 18.1% over the previous period ending June 30, 2006. 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 18.1% the past eight periods and the increases have nearly recovered to pre-December 2003 rates. Total deductions include contractual adjustments and charity care. Deductions are the difference between what the hospital billed and what they were paid.

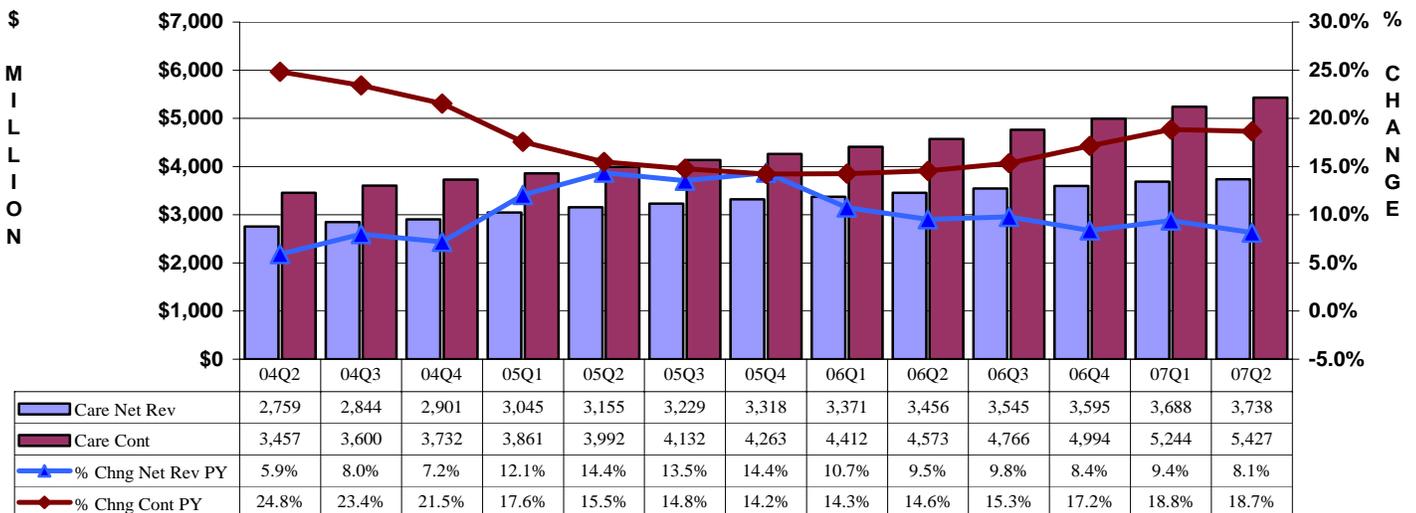
Total Deductions from Revenue



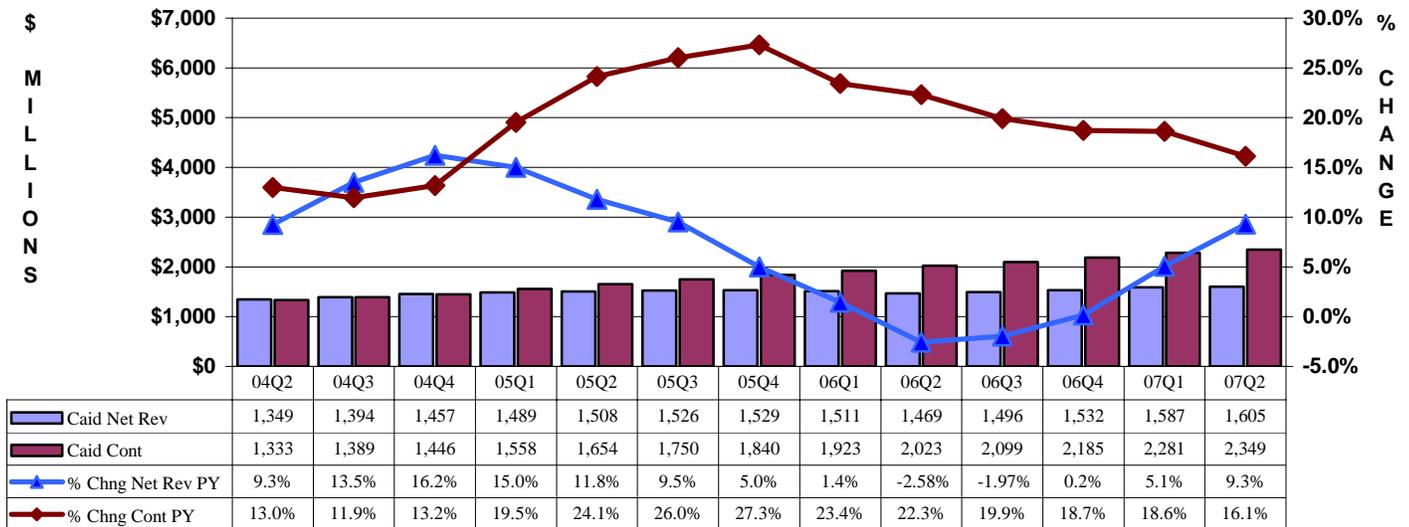
Contractual Adjustments

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, \$6.732 billion and deductions of \$5.871 billion. Medicare's net revenue of \$3.738 billion is much less than Other however the contractuals are similar to Other at \$5.427 billion. Medicaid net revenue was \$1.605 billion and deductions were \$2.649 billion. Based on the hospital's rate sheet, or billed revenue, hospitals bill Medicare an average of \$2.45 for each dollar they receive, Other payers an average of \$1.87 and Medicaid an average of \$2.46.

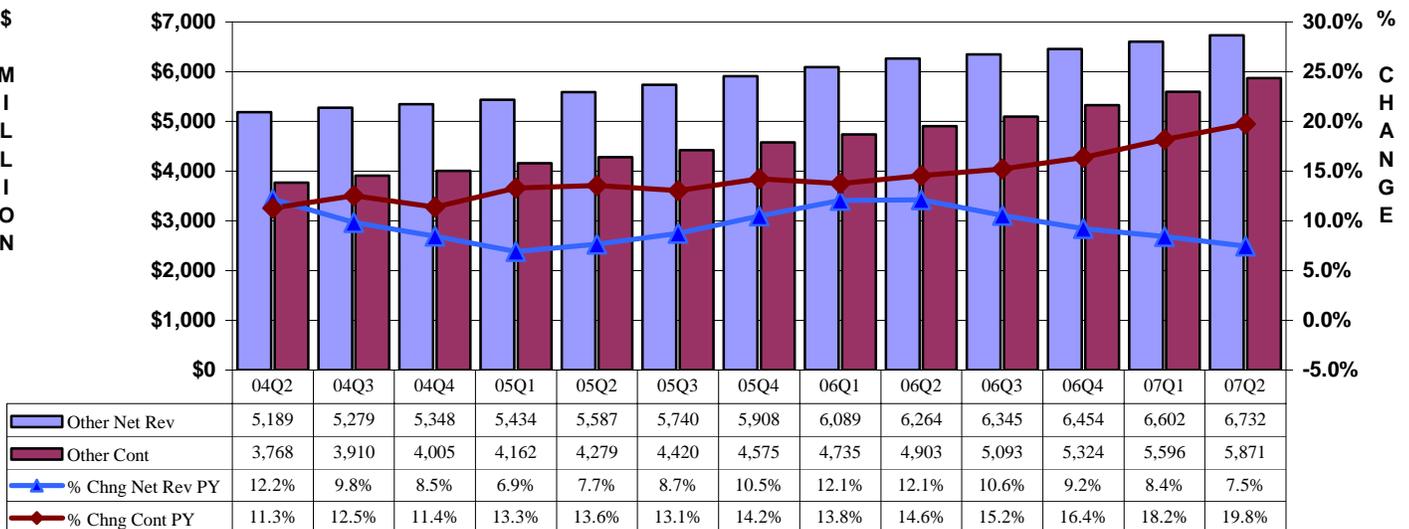
Medicare Contractuals



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 5.7% and bad debt has increased by 23.8%, for a total increase in uncompensated care of 14.1%.

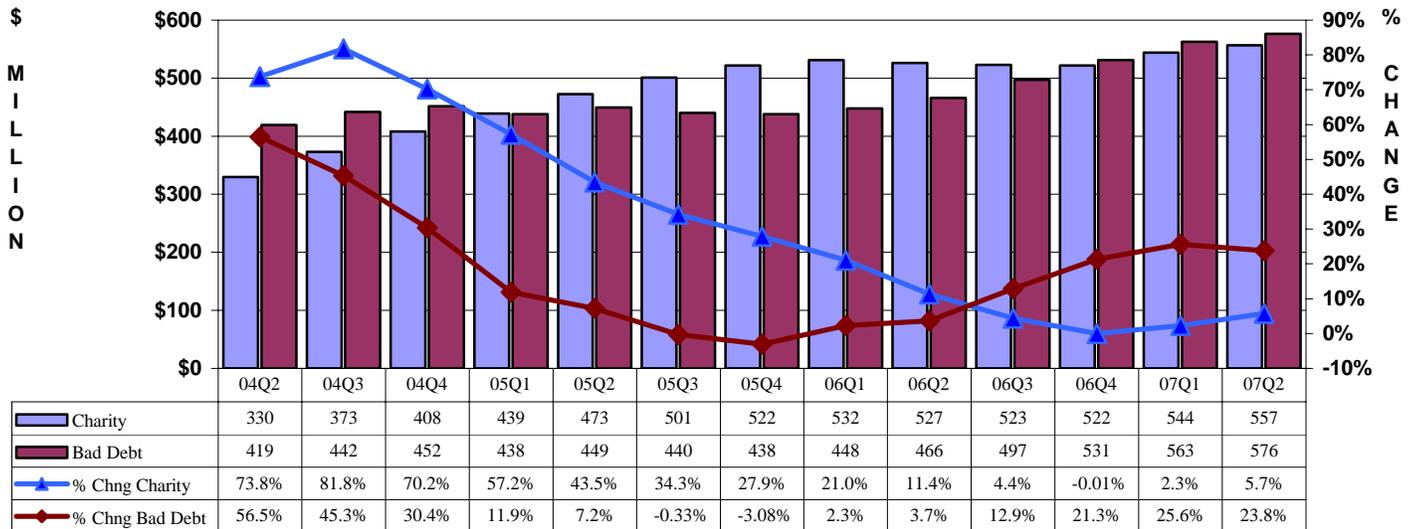
Charity

While charity care is only 2.16% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. Recently, during the June 30, 2006 to June 30, 2007 period, charity care has increased 5.75% or \$30.2 million. The rate of increase in charity care has been generally declining since the fourth quarter of 2003, although the past two quarters have seen small increases in that rate.

Bad Debt

The bad debt dollar amount has grown from \$466 million for the four quarters ending June 30, 2006 to \$576 million for the period ending June 30, 2007 which is a 23.8% increase. Bad debt has been increasing since the four quarters ending December 31, 2005. Bad debt total dollars have again surpassed those of charity care, returning to the pattern that existed prior to the period ending March 31, 2005. Prior to that time bad debt always was a larger dollar amount.

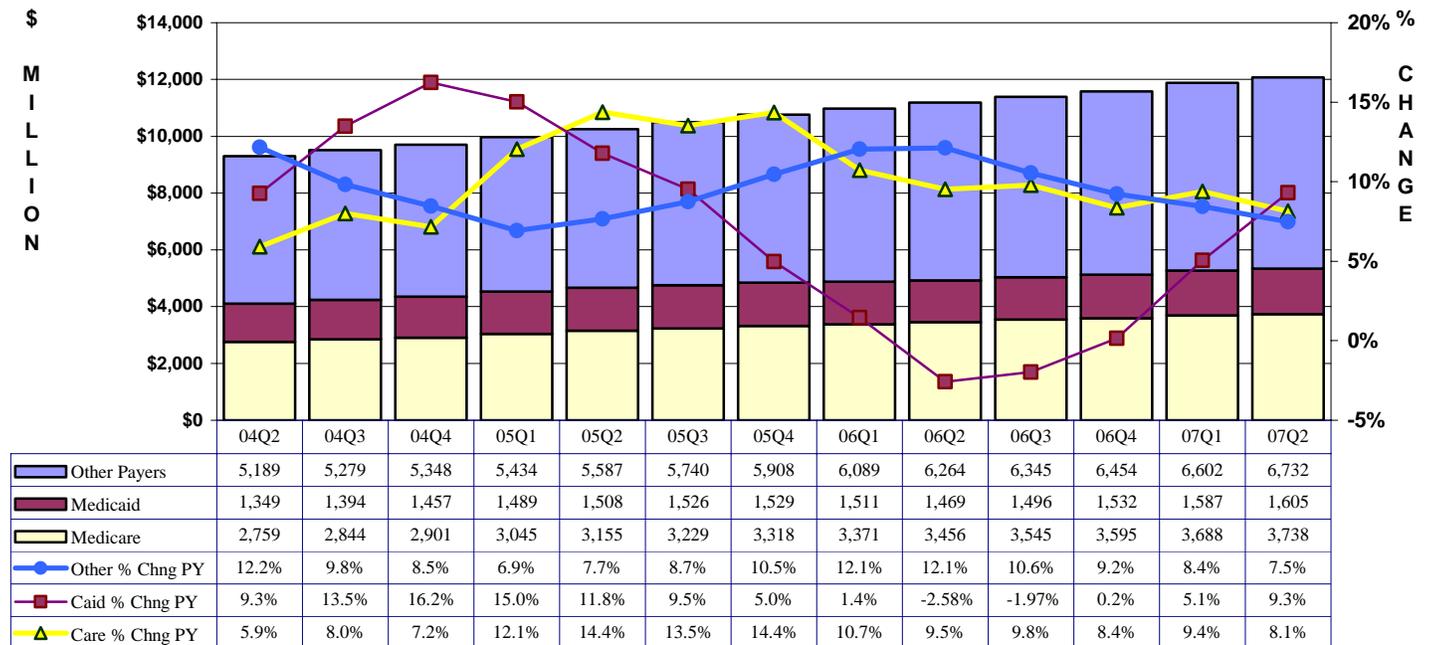
Charity and Bad Debt



Net Patient Services Revenue

During the twelve month period ended June 30, 2006 net patient service revenue grew by 8.03%, or \$856 million, from \$10.7 billion to \$11.5 billion. Other payer continues its strong percentage and dollar growth (7.5%, \$468 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 an 8.1% increase and Other had a 7.5% increase over the twelve month period ending June 30, 2006. Medicaid revenue increased 14.14% while Medicaid deductions increased by 16.12%, increasing the net patient service revenue for Medicaid by 9.29% from the previous period.

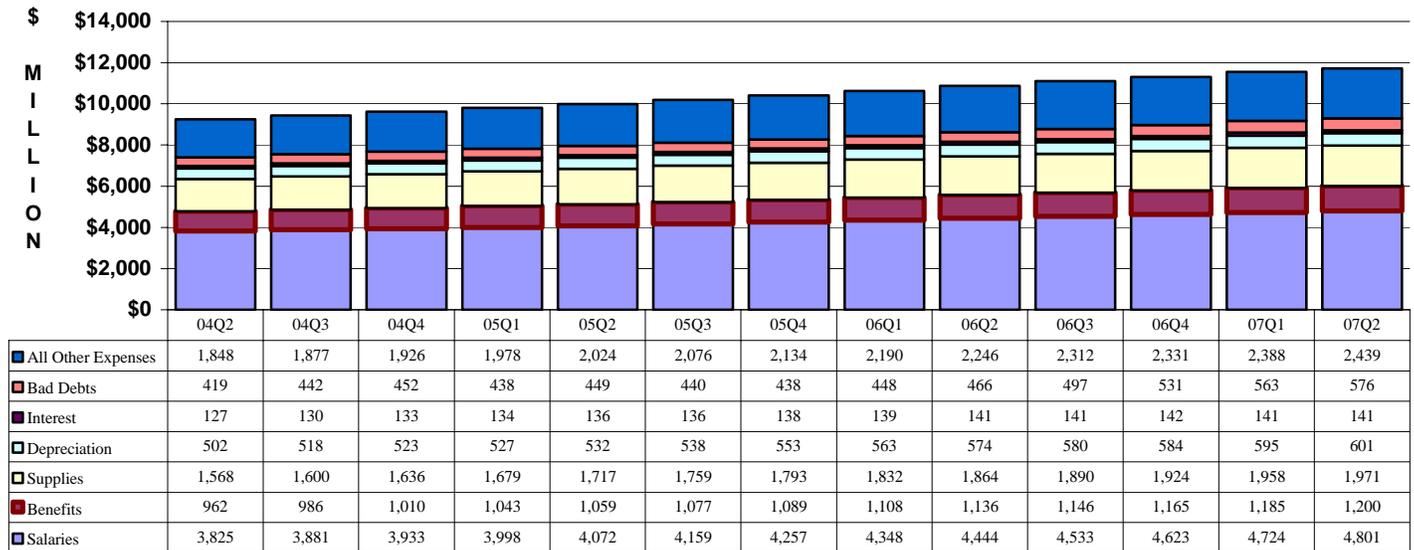
Net Patient Service Revenue by Payer



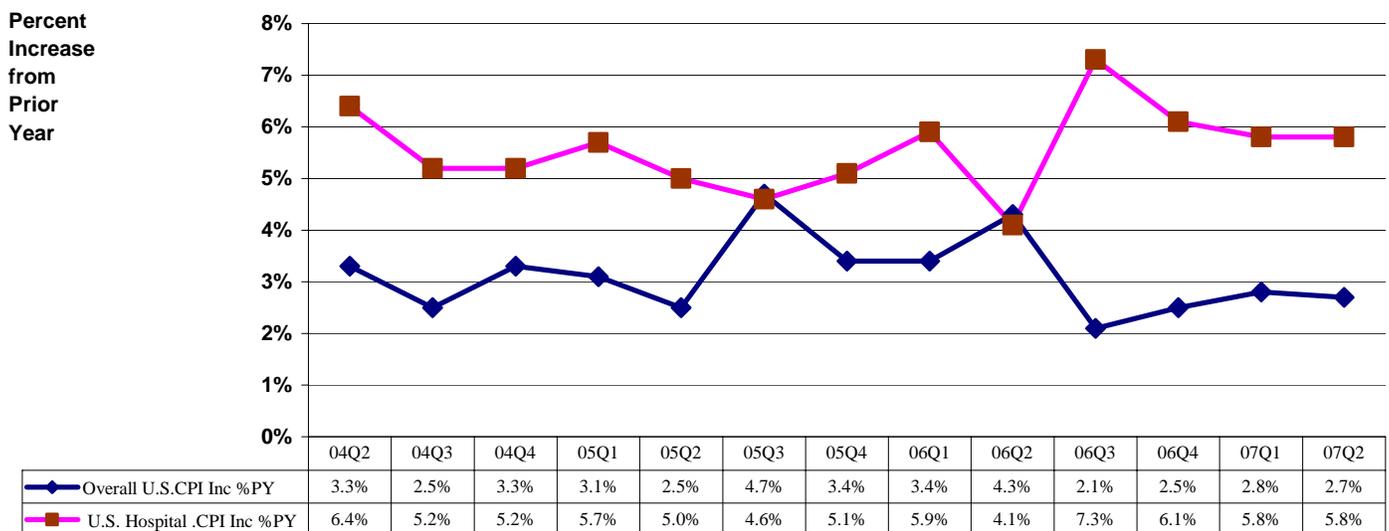
Operating Expenses

Operating expenses are the costs of providing health care services to hospital patients. Growing by 7.9%, or \$859 million, operating expenses reached \$11.7 billion in the twelve month period ended June 30, 2007. Adjusted discharges only increased .07% during the same time period. Operating expenses per adjusted discharge increased by 7.82%. The 7.82% increase exceeded the 2.7% annual increase in the overall United States consumer price index as well as the 5.8% annual increase in the United States hospital services component of the index for the same time period of September 2006 to September 2007. The category with the largest dollar increase in operating expenses was salaries at 8.0% or \$357 million for a total of \$4,801 million. The category with the largest percentage increase in operating expenses was bad debt at 23.8%, or \$111 million for a total of \$576 million. Interest expense had the smallest dollar and percentage increases during the same period.

Operating Expense



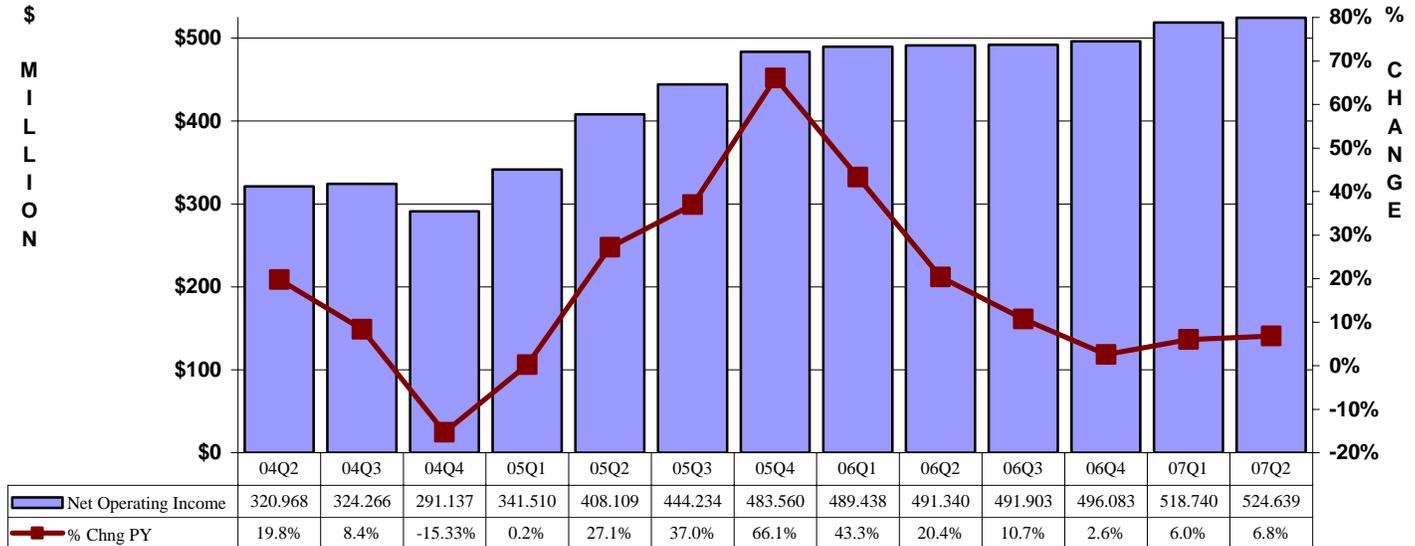
United States Consumer Price Index change from previous year (Overall vs. Hospital)



Net Operating Income

During the four quarters ended June 30, 2007 net operating income advanced to \$527 million, which was up 6.85% 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 7.86% and operating expense, which grew 7.9%, caused the 6.85% change in net operating income. Net operating income includes other operating income.

Net Operating Income

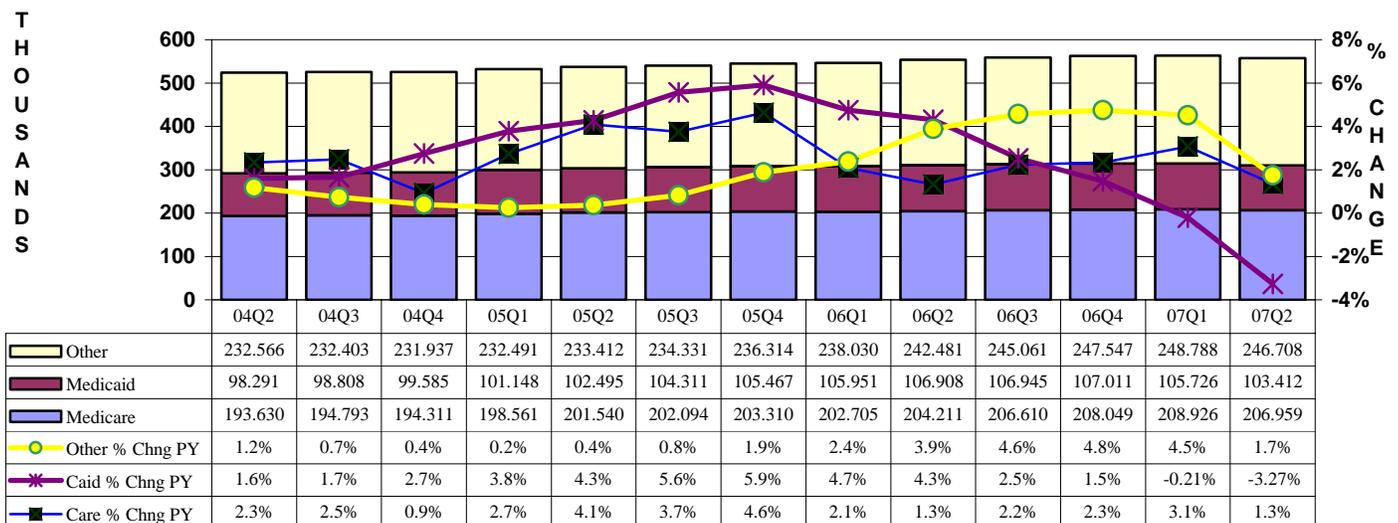


UTILIZATION INDICATORS

Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow, reaching a total of 557,079 discharges during the four quarters ending June 30, 2007. This was a gain of only 3,479 discharges, or .63%, over the corresponding 2006 period. Medicaid discharges decreased 3.27%, while Medicare discharges increased 1.3% and Other discharges increased 1.7%.

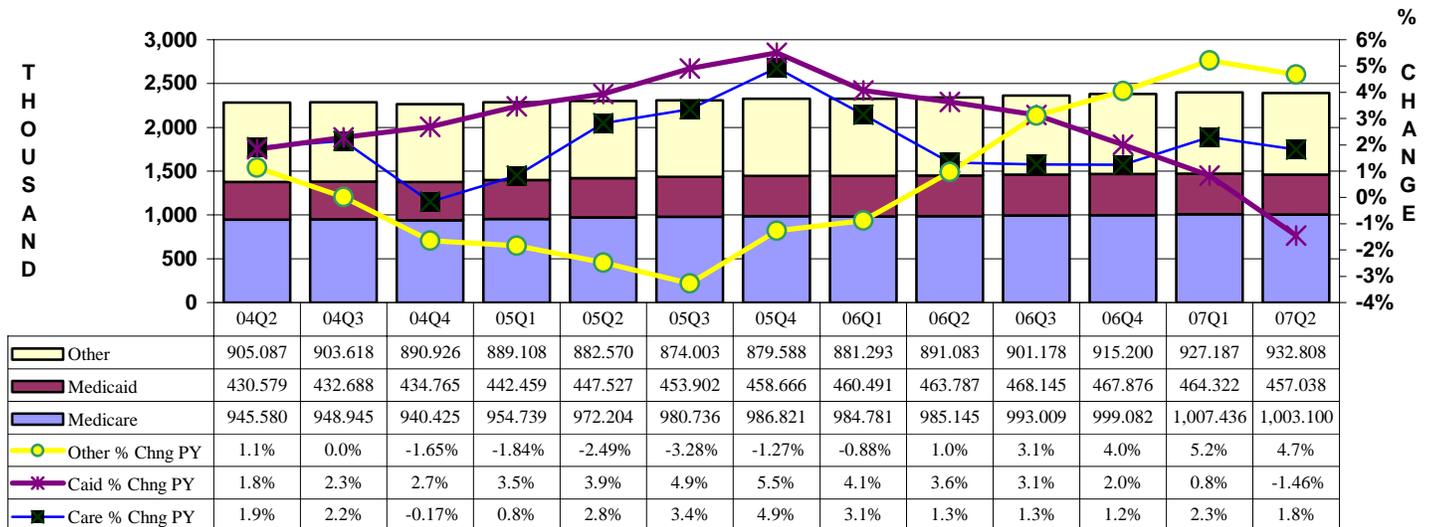
Discharges by Payer



Patient Days

Patient days also continued to grow, reaching a total of 2,392,946 during the four quarters ending June 30, 2007. This was a gain of 52,931 patient days, or 2.26%, over the corresponding year ago period. Medicare days grew 1.8%, Medicaid days declined 1.46% and Other increased by 4.7%.

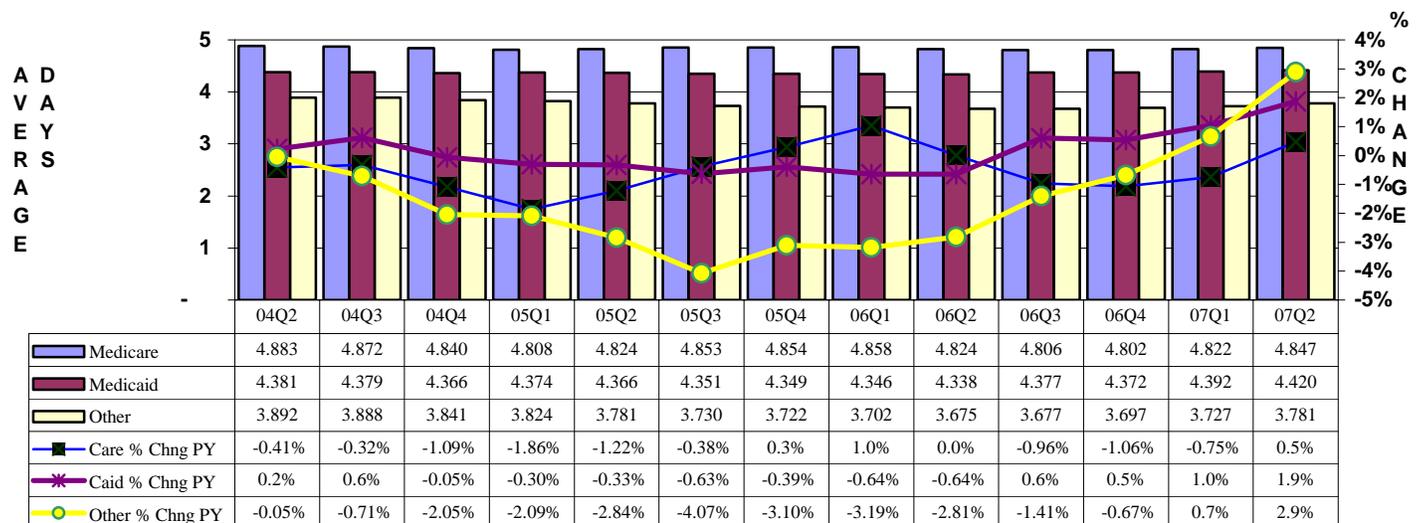
Patient Days by Payer



Length of Stay

Since the percentage increase in statewide discharges during the four quarters ending June 30, 2007 was less than the increase of patient days, statewide average length of stay increased slightly to 4.30 days, or 1.62%. 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, 2007 the average length of stay has increased by .07 days from the previous period ending June 30, 2006. In the latest period, Medicare average length of stay was 4.85, Medicaid was 4.42 and Other was 3.768. Medicare ALOS was 9.7% higher than Medicaid and 28.2% higher than Other payer.

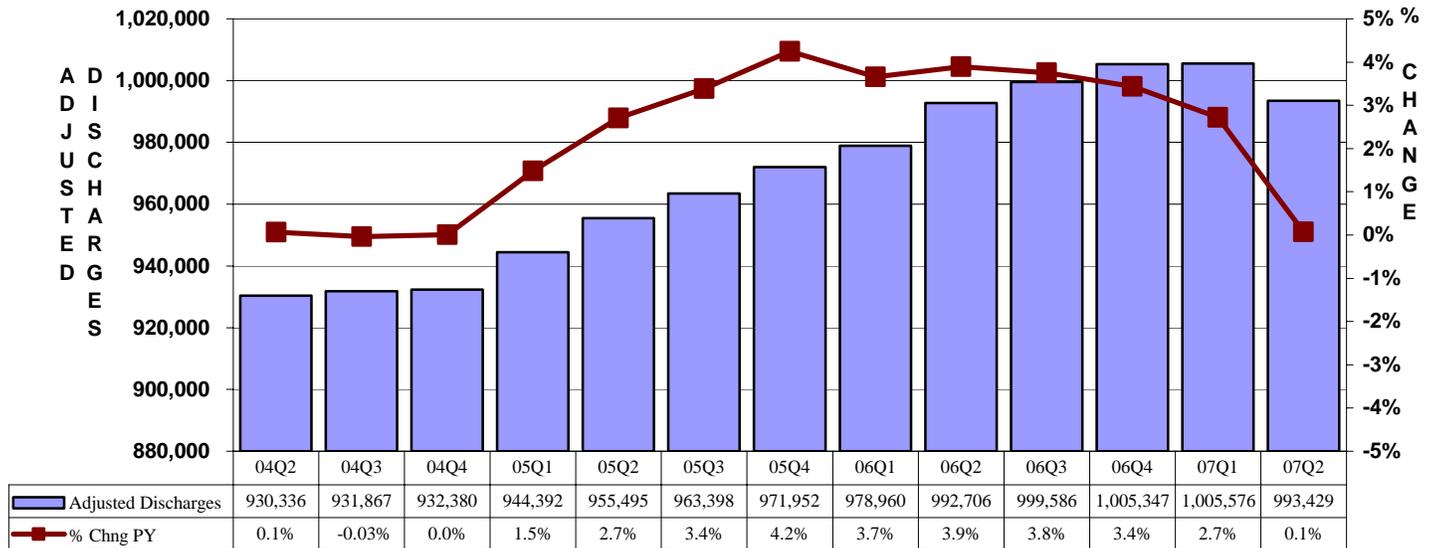
Length of Stay by Payer



Adjusted Discharges

Adjusted discharges reached a total of 993,429 in the four quarter period ended June 30, 2007. This was an increase of only 724 adjusted discharges, or .07%, from the four quarter period ended June 30, 2006. The percentage increase was the smallest one year increase in adjusted discharges since the four quarters ended December 31, 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

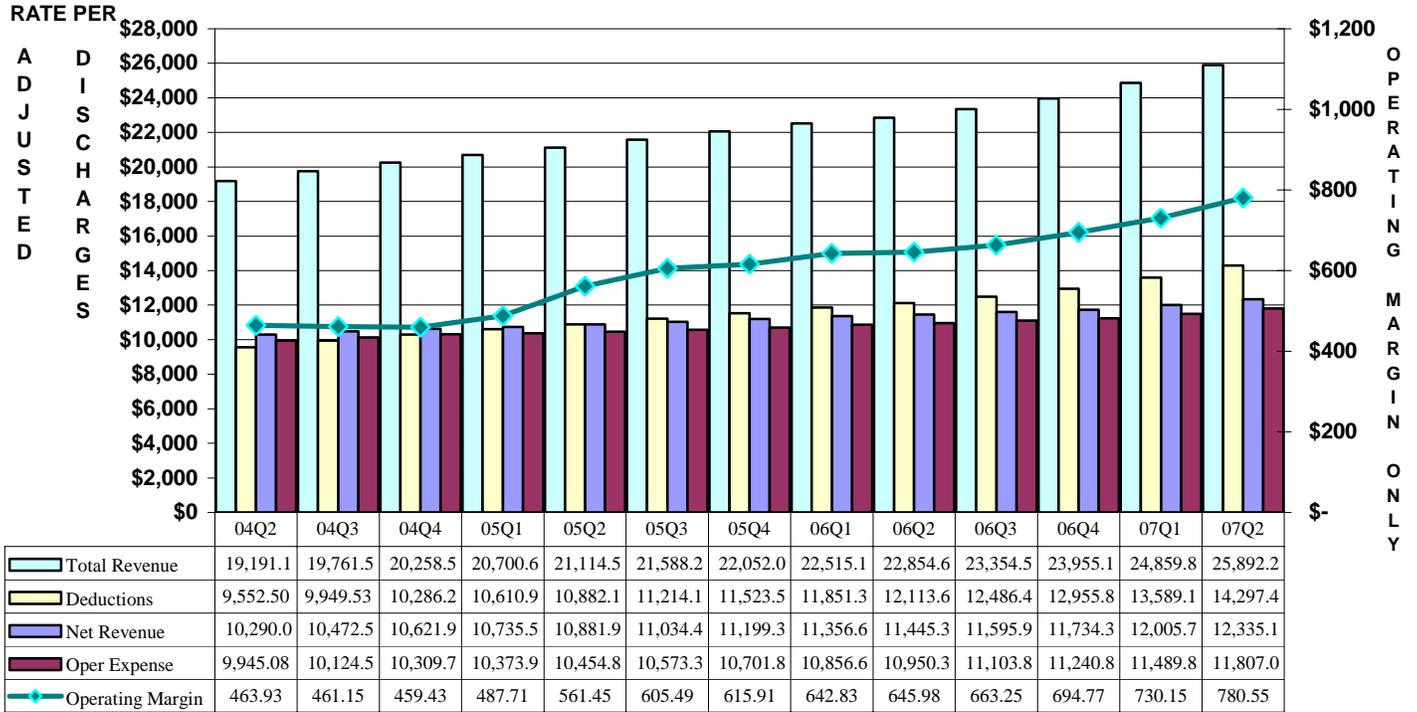


OPERATING INDICATORS

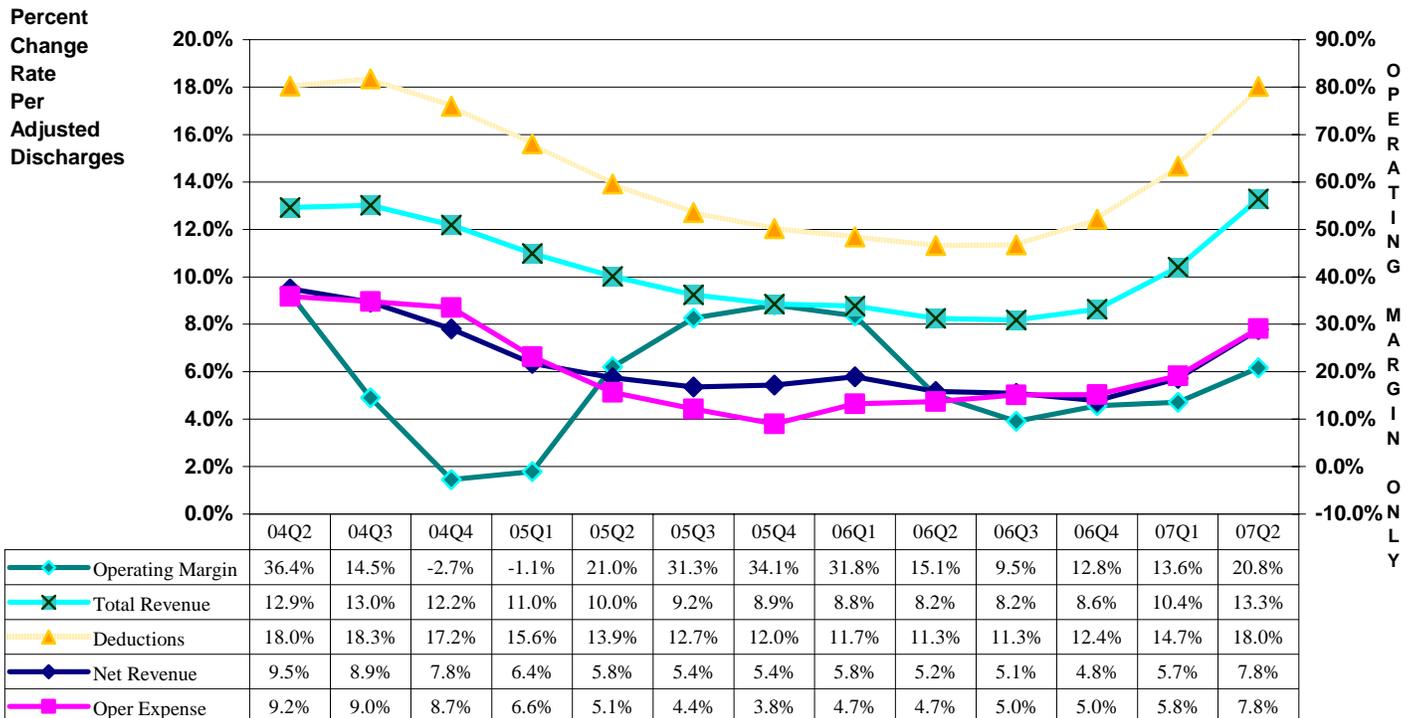
Rates per Adjusted Discharge

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. 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



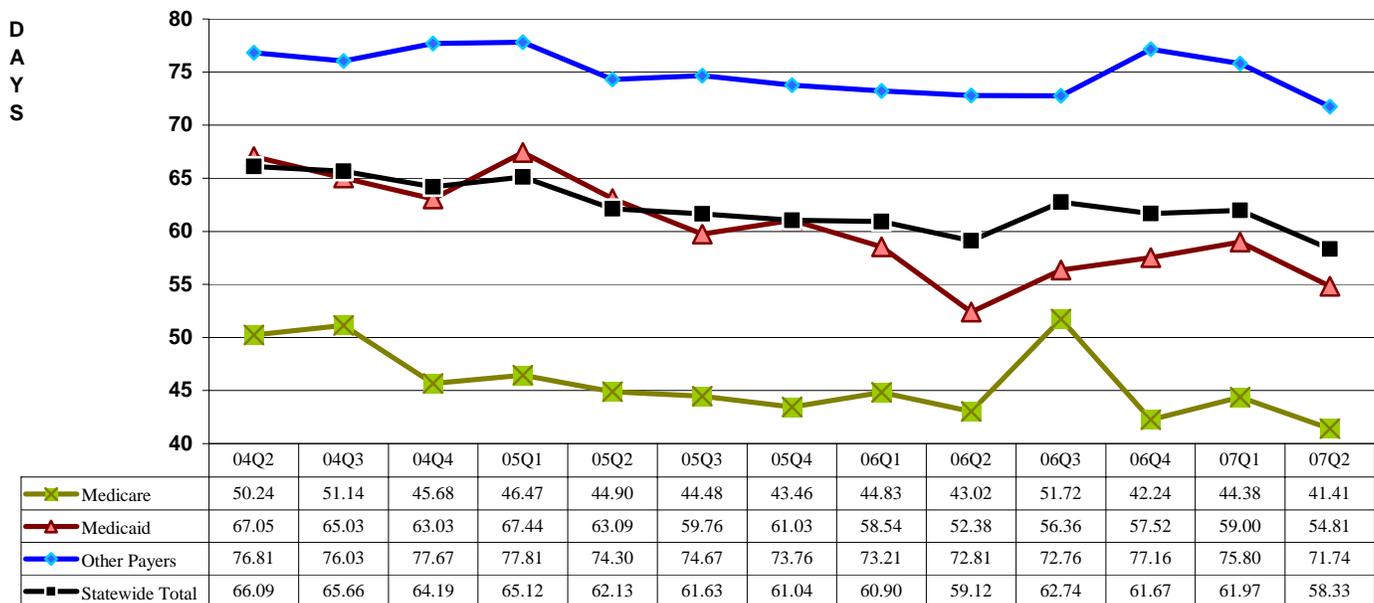
FINANCIAL RATIOS

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 58.3 days for the four quarter period ending June 30, 2007. This was a reduction of .8 days, or 1.34%, from the corresponding year earlier period. Medicare accounts receivable decreased by 1.6 days, or 3.74%, to 41.4 days. Accounts receivable for Medicaid increased by 2.4 days, or 4.65%, to 54.8 days. A reduction of 1.1 days, or 1.47%, to an average of 71.7 days was also noted for the Other payer groups.

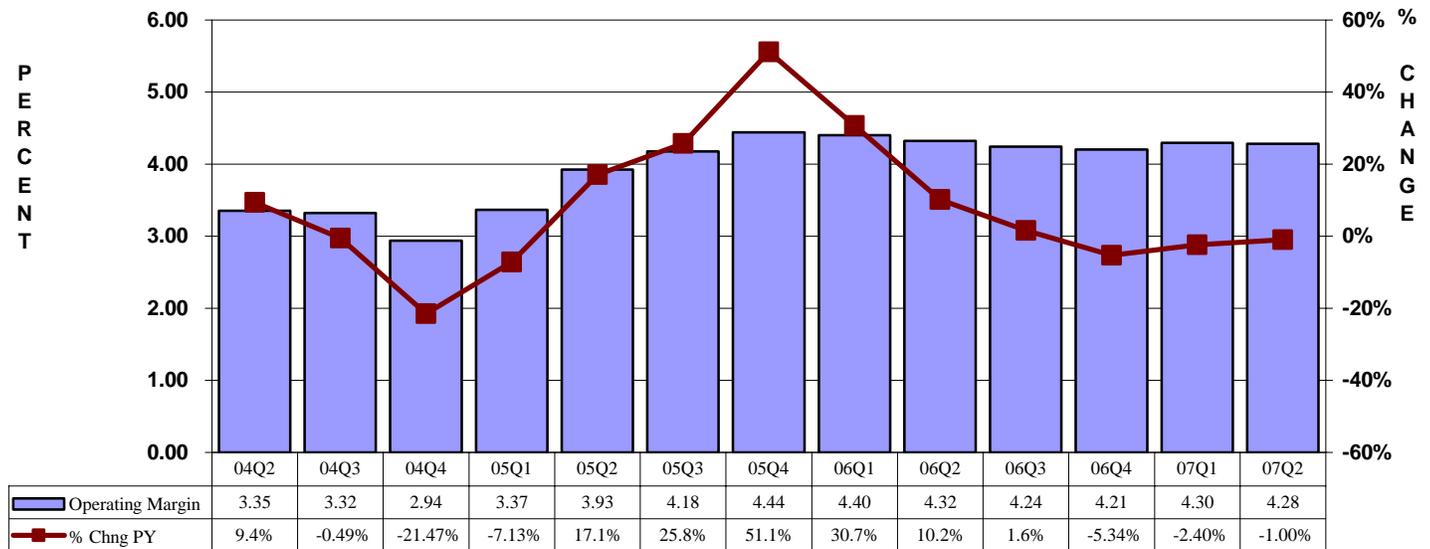
Days in Accounts Receivable by Payer



Operating Margin

During the twelve month period ended June 30, 2007 operating margin reached 4.28%, which was 1% below the year earlier level. The current period is slightly below the recent high level of 4.44 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.

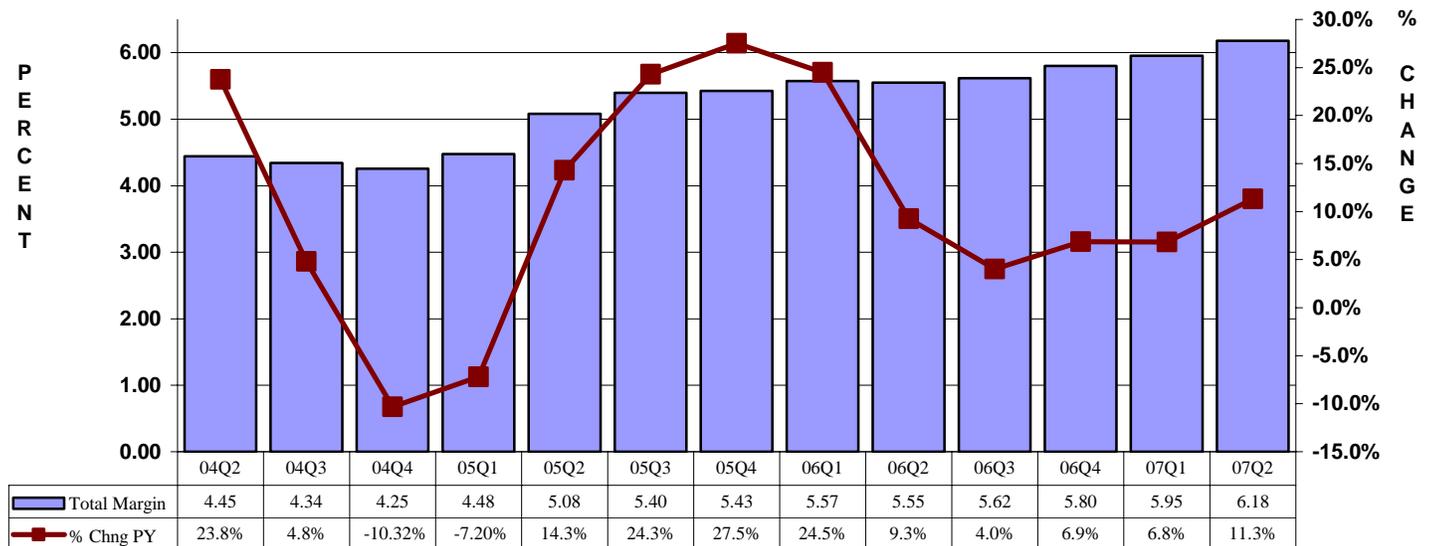
Operating Margin



Total Margin

During the twelve month period ending June 30, 2007 operating margin reached 6.18%, which was 11.3% 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

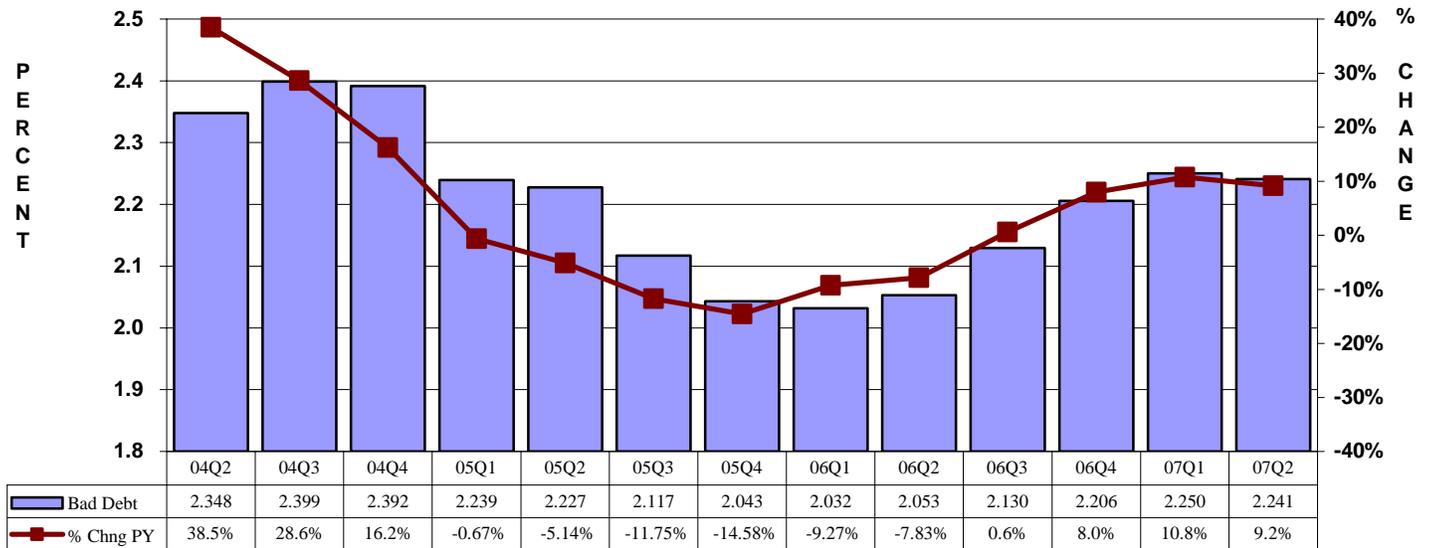
Uncompensated Care Proportion

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 4.41%, which was an increase of .73% over the previous year.

Bad Debt

In the four quarter period ended June 30, 2007, the bad debt proportion reached 2.24%, which was an increase of 9.17% from the previous year.

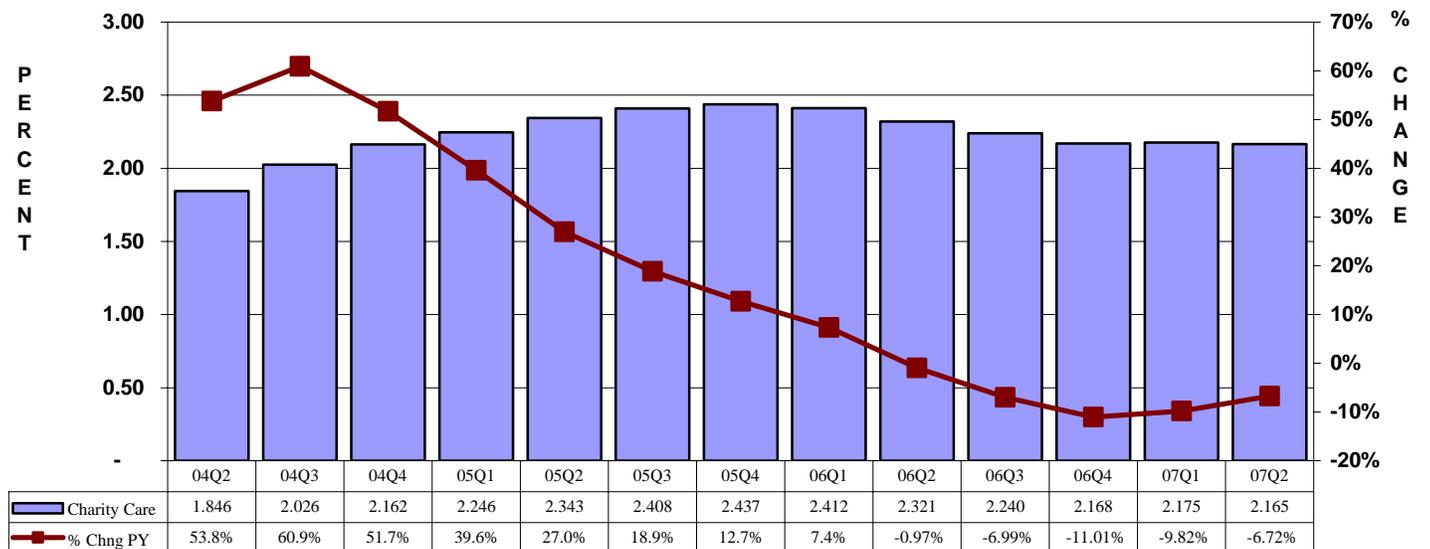
Bad Debt as a Percent of Total Revenue



Charity Care

The charity care proportion reached 2.17%, which was a decrease of 6.72% over the previous year. This was the fifth consecutive quarter showing a decline in this proportion.

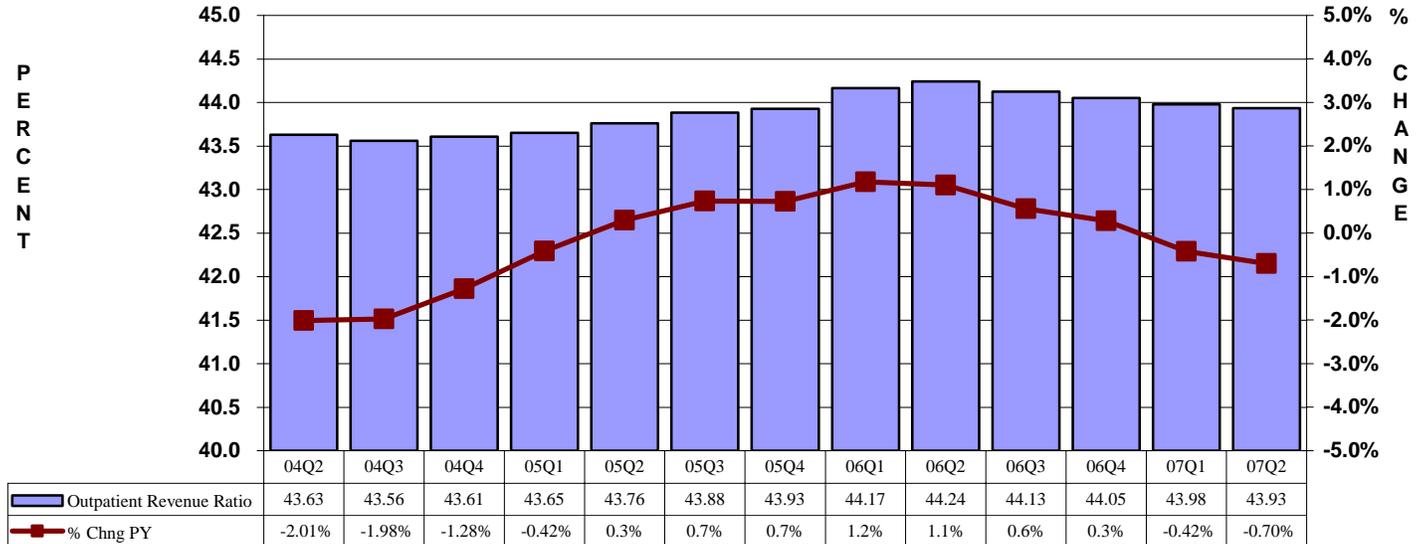
Charity Care as a Percent of Total Revenue



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, 2006 and June 30, 2007 the outpatient revenue percentage decreased from 44.24% to 43.93%, or .7%. 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.

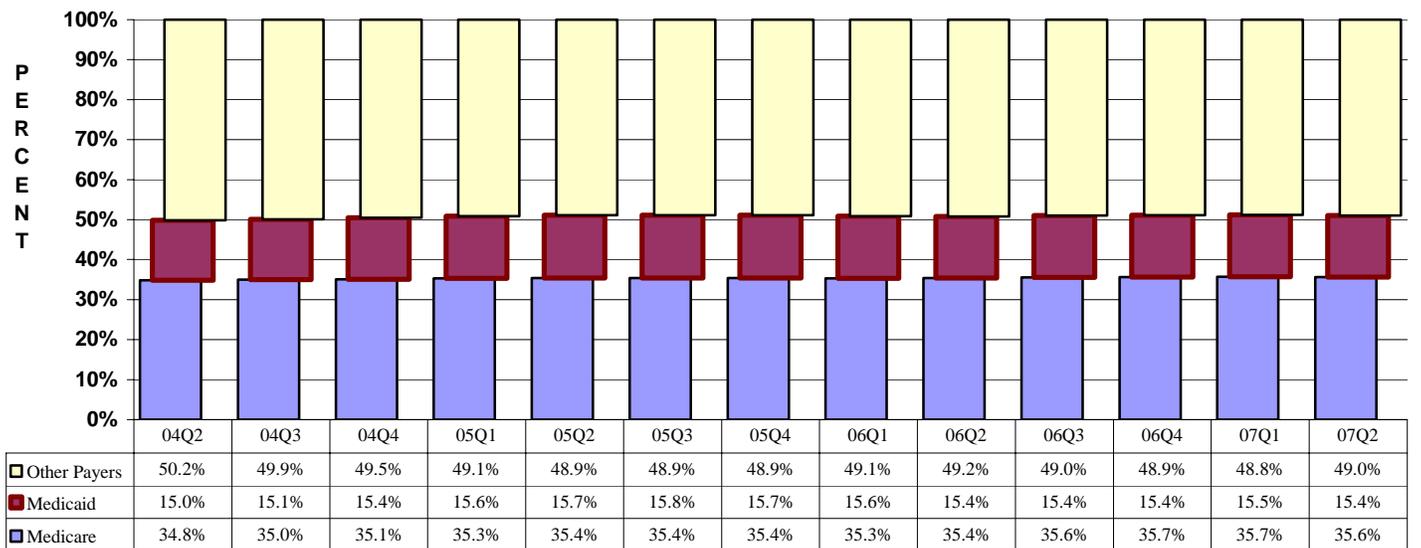
Outpatient Revenue as a percent of Total Revenue



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, 2007 the Medicare percentage was 35.63%, a decrease of .67% over the same period in 2006. 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 51.01% 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 June 30 2006	12 Mo. Ended June 30 2007	Total Change	Percent Change
Total Patient Revenue				
Inpatient	12,652,341,916	14,424,014,607	1,771,672,691	14.00%
Outpatient	10,037,857,829	11,300,834,922	1,262,977,093	12.58%
Total	22,690,199,745	25,724,849,529	3,034,649,784	13.37%
Medicare	8,029,131,786	9,164,221,008	1,135,089,222	14.14%
Medicaid	3,492,061,342	3,954,804,669	462,743,327	13.25%
Other	11,166,759,637	12,603,065,658	1,436,306,021	12.86%
Deductions From Revenue				
Contractual Adjustments				
Medicare	4,573,111,888	5,426,541,051	853,429,163	18.66%
Medicaid	2,023,100,908	2,349,310,961	326,210,053	16.12%
Other	4,902,534,067	5,870,894,589	968,360,522	19.75%
Total	11,498,746,863	13,646,746,601	2,147,999,738	18.68%
Charity	526,521,154	556,794,149	30,272,995	5.75%
Total	12,025,268,017	14,203,540,750	2,178,272,733	18.11%
Uncompensated Care				
Bad Debt	465,741,512	576,428,850	110,687,338	23.77%
Charity	526,521,154	556,794,149	30,272,995	5.75%
Total	992,262,666	1,133,222,999	140,960,333	14.21%
Net Patient Revenue				
Medicare	3,456,019,898	3,737,679,957	281,660,059	8.15%
Medicaid	1,468,960,434	1,605,493,708	136,533,274	9.29%
Other	6,264,225,570	6,732,171,069	467,945,499	7.47%
Total	10,664,931,728	11,521,308,779	856,377,051	8.03%
Other Operating Revenue	699,160,506	735,565,922	36,405,416	5.21%
Total Operating Revenue	11,364,092,234	12,256,874,701	892,782,467	7.86%
Total Operating Expenses	10,870,505,185	11,729,477,561	858,972,376	7.90%
Net Operating Income	493,587,049	527,397,140	33,810,091	6.85%
Non-Operating Income	120,819,780	215,995,877	95,176,097	78.78%
Tax Revenue	26,859,188	32,029,492	5,170,304	19.25%
Net Total Income	641,266,017	775,422,509	134,156,492	20.92%
Gross Accounts Receivable				
Medicare	946,362,815	1,039,774,809	93,411,994	9.87%
Medicaid	501,133,119	593,912,989	92,779,870	18.51%
Other	2,227,430,555	2,477,058,410	249,627,855	11.21%
Total	3,674,926,489	4,110,746,208	435,819,719	11.86%
Days in Accounts Receivable				
Medicare	43.0	41.4	(1.6)	-3.74%
Medicaid	52.4	54.8	2.4	4.65%
Other Payers	72.8	71.7	(1.1)	-1.47%
Statewide Total	59.1	58.3	(0.8)	-1.34%
Utilization				
Discharges	553,600	557,079	3,479	0.63%
Patient Days	2,340,015	2,392,946	52,931	2.26%
Length of Stay	4.23	4.30	0.07	1.62%
Adjusted Discharges	992,706	993,429	724	0.07%
Rates per Adjusted Discharge				
Total Revenue	22,856.93	25,895.00	3,038.07	13.29%
Deductions	12,113.63	14,297.49	2,183.86	18.03%
Net Revenue	11,447.60	12,337.95	890.35	7.78%
Operating Expense	10,950.38	11,807.06	856.68	7.82%
Net Margin	645.98	780.55	134.57	20.83%
Financial Ratios				
Operating Margin	4.32	4.28	(0.04)	-1.00%
Total Margin	5.55	6.18	0.63	11.31%
Deductible Proportion	53.00	55.22	2.22	4.18%
Contractual Proportion - Total	50.68	53.05	2.37	4.68%
Contractual Proportion - Medicare	56.96	59.21	2.26	3.96%
Contractual Proportion - Medicaid	57.93	59.40	1.47	2.54%
Contractual Proportion - Other	43.90	46.58	2.68	6.10%
Bad Debt Proportion	2.05	2.24	0.19	9.17%
Charity Proportion	2.32	2.16	(0.16)	-6.72%
Uncompensated Care Proportion	4.37	4.41	0.03	0.73%
Total Revenue/Inpatient Revenue	1.79	1.78	(0.01)	-0.55%
Outpatient Revenue Percent	44.24	43.93	(0.31)	-0.70%
Medicare Revenue Percent	35.39	35.63	0.24	0.67%
Medicaid Revenue Percent	15.39	15.38	(0.02)	-0.11%

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 2006 and the first two quarters of 2007. 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, 2007

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