

## Introduction

The hospTRENDS Featured Topic this quarter is a discussion of recent growth trends in selected inflation-adjusted income items among Washington hospitals. 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. For the last two periods, however, the increase was only 0.5%. 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 1.3% in this period. 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 4.29 and continues what is now a 6 period increase.

Deductions from revenue grew at a 17.1% rate, returning to a cycle where the growth in deductions had been slightly smaller each period from 2003 until the fourth quarter of 2006. The operating revenue again grew slightly faster (10.3%) than operating expenses (9.5%) which translates into an operating margin increase of 29.2% over the previous period. Operating expense grew by 9.5% 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 17.6% compared to recent growth of up to 81.2%. Bad debt continued recent trends with an increase of 19.1%.

## Statewide Summary of Quarterly Reports

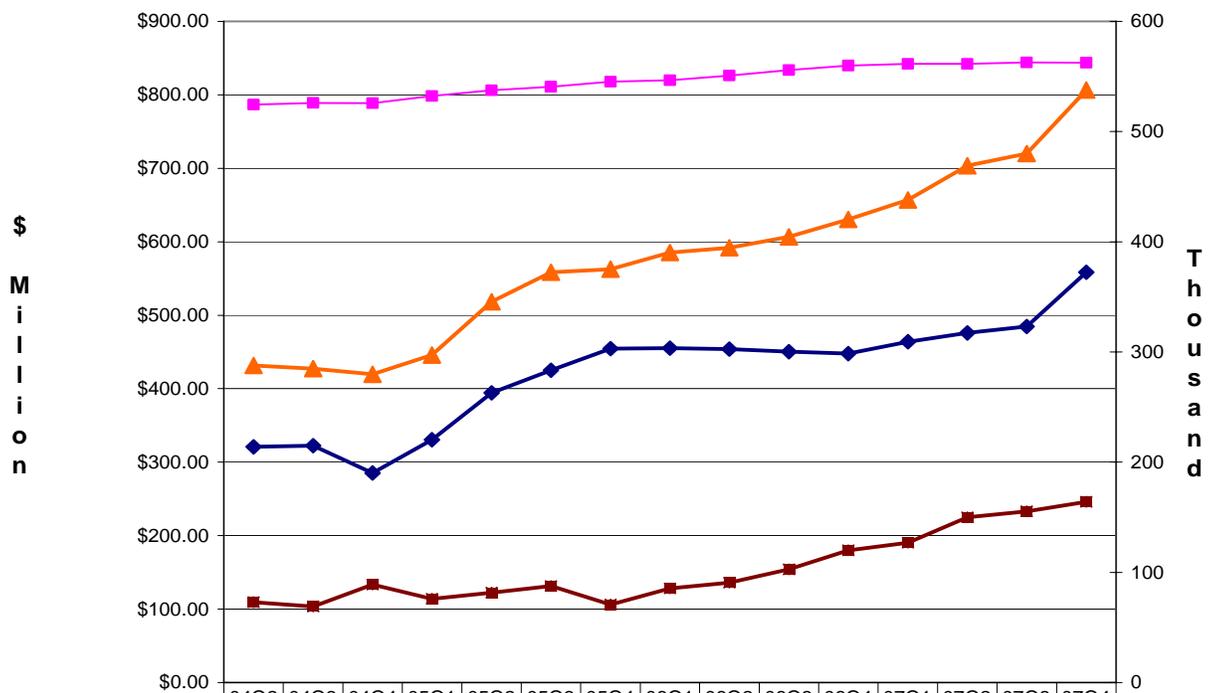
	4 Quarter Period Ending		Percent	2007
	12/31/2006	12/31/2007	Difference	Percent of Tot Rev
Discharges	559,848	562,510	0.5%	
Patient Days	2,381,952	2,413,804	1.3%	
Average Length of Stay	4.25	4.29	0.9%	
+ Total Revenue	24,089,260,544	27,461,796,672	14.0%	
- Deductions from Revenue	13,024,295,261	15,257,509,358	17.1%	55.6%
= Net Revenue	11,064,965,283	12,204,287,314	10.3%	44.4%
+ Other Operating Revenue	739,179,675	820,190,942	11.0%	3.0%
= Operating Revenue	11,804,188,958	13,024,478,256	10.3%	47.4%
- Operating Expenses	11,305,426,471	12,380,342,242	9.5%	45.1%
= Operating Margin	498,718,487	644,136,014	29.2%	2.3%
+ Other Income/Tax Revenue	199,237,911	282,539,269	41.8%	1.0%
= Total Margin	697,956,398	926,675,283	32.8%	3.4%
Charity Care	519,769,180	611,301,148	17.6%	2.2%
Bad Debt	531,035,758	632,369,546	19.1%	2.3%
Operating Margin	4.20	4.93	17.3%	
Total Margin	5.79	6.95	19.9%	

## Featured Topic

### The Little Things Mean a Lot

With apologies to Kitty Kallen for the theft of her famous song title, this month's featured topic is recent growth in operating margins. As noted on page 11 of this issue of hospTRENDS, hospital operating margin per adjusted discharge in Washington has increased only .73 percentage points in the past year, but that equates to a total of \$145,417,530 additional dollars. Operating margin has been growing in recent years, both in absolute and adjusted terms. The table below shows inflation-adjusted<sup>1</sup> values for net revenue, net operating income, and non-operating income from the year ending June 30, 2004, through the year ending December 31, 2007. Both operating and non-operating income are rising steadily, despite fairly flat rates of increase in discharges, particularly in the last year. In the last twelve months of the data presented in this report, we see an increase in inflation-adjusted net operating income of 24.7%, an increase in inflation-adjusted non-operating income of 36.6%, both of which contribute to an increase in inflation-adjusted net revenue of 27.9%. In nominal terms, Washington hospitals recorded \$917.14 in operating income per adjusted discharge, the highest value on record and nearly twice the \$472.38 per adjusted discharge reported for the same period in 2003.

**Discharges and Inflation-Adjusted Income**



	04Q2	04Q3	04Q4	05Q1	05Q2	05Q3	05Q4	06Q1	06Q2	06Q3	06Q4	07Q1	07Q2	07Q3	07Q4
◆ Inflation Adjusted Net Operating Income	320.9	322.4	285.2	330.4	394.3	425.2	454.5	455.2	453.7	450.4	447.8	463.8	475.8	484.4	558.3
▲ Inflation Adjusted Net Revenue	431.6	427.3	419.7	445.7	518.4	558.3	562.6	585.2	591.9	606.8	630.4	656.9	703.4	720.0	806.4
■ Inflation Adjusted Non-Operating Income	109.4	103.6	133.2	113.8	122.4	131.3	106.3	128.1	136.1	154.1	179.9	190.4	224.9	233.1	245.8
■ Discharges	524.5	526	525.8	532.2	537.4	540.7	545.1	546.5	550.8	555.8	559.8	561.3	561.5	562.6	562.5

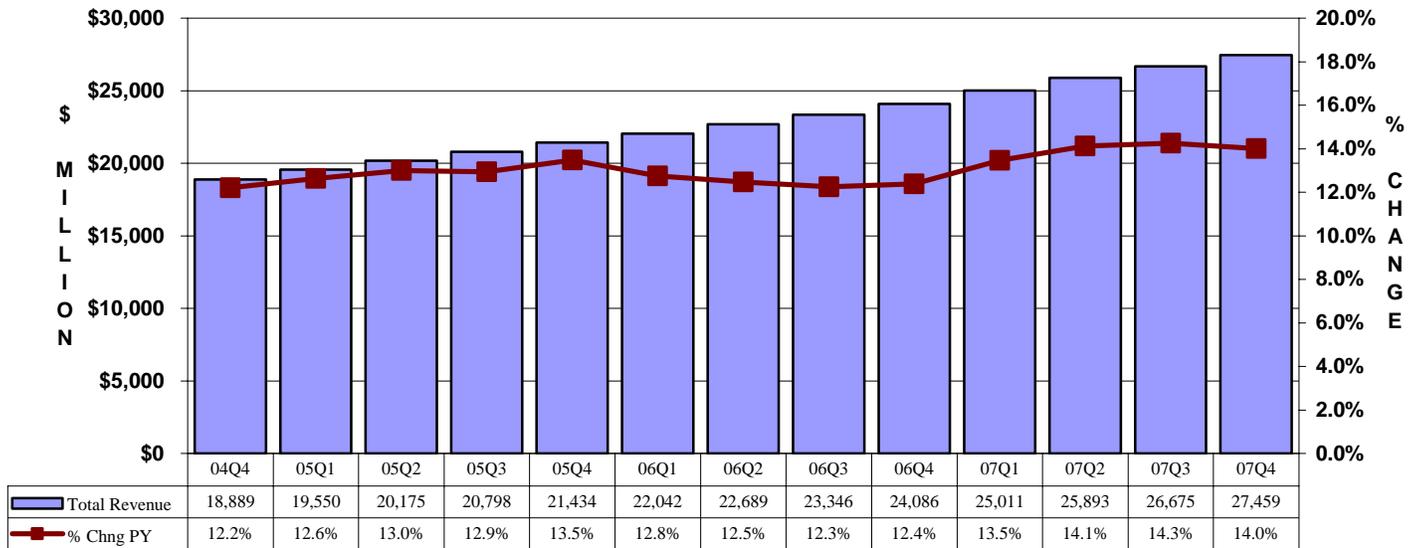
## FINANCIAL INDICATORS

### Total Patient Service Revenue

Total billed charges for patient services, which is identified as total patient service revenue or total revenue, increased by \$3.4 billion from \$24.1 billion to \$27.5 billion for the period ending December 31, 2007. The annual increase rate of 14.0% is slightly higher than recent rates. The annual dollar increase had been between \$2.05 and \$2.55 billion each four quarter year for sixteen periods, but has now advanced to over \$3.09 billion in each of the last three 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.

<sup>1</sup> Income values adjusted using Producer Price Index (PPI) for hospitals published by US Bureau of Labor

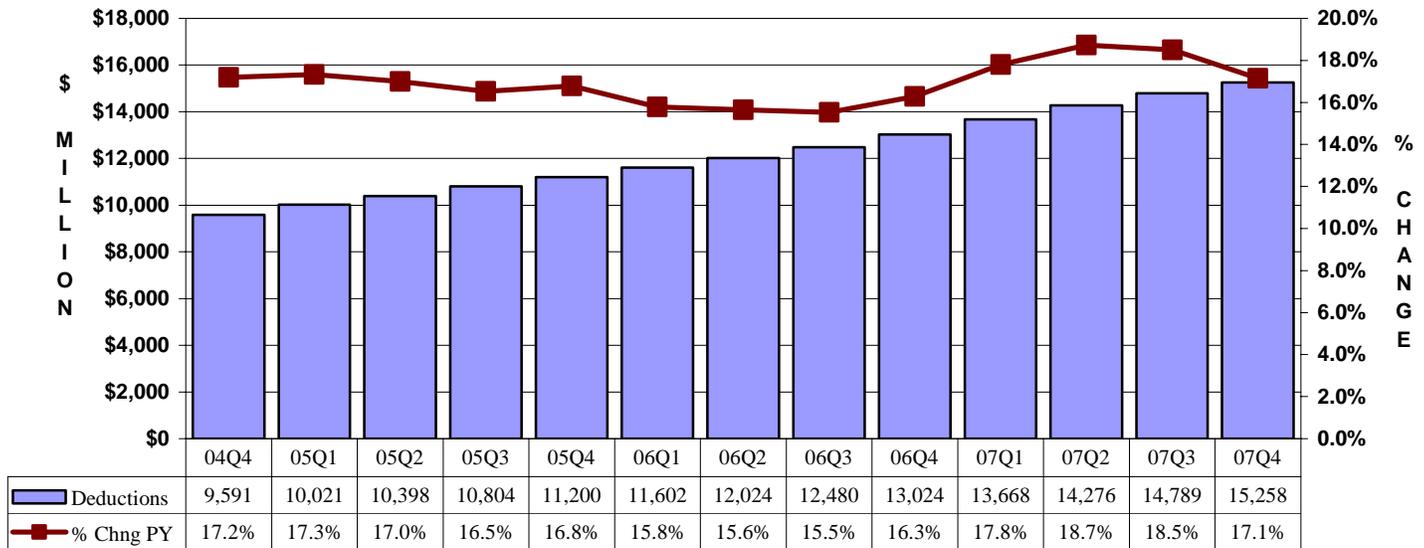
### Total Patient Service Revenue



### Total Deductions from Revenue

For the twelve months ended December 31, 2007 total deductions from revenue reached \$15.3 billion. This was an increase of \$2.2 billion, or 17.1% over the previous period ending December 31, 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 18.7% the past nine 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

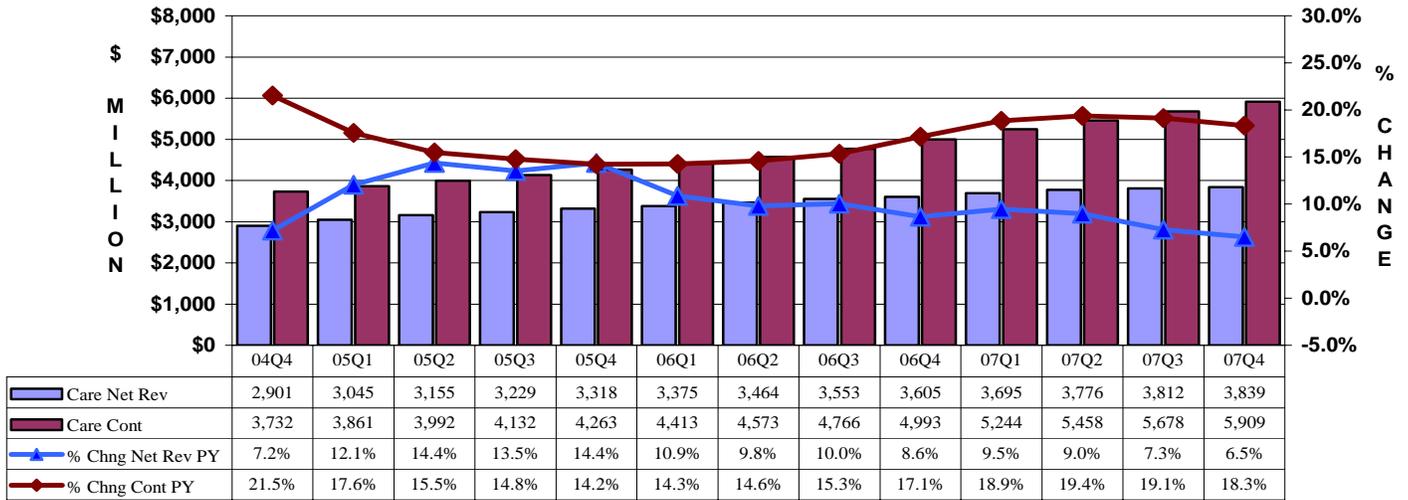


### Contractual Adjustments

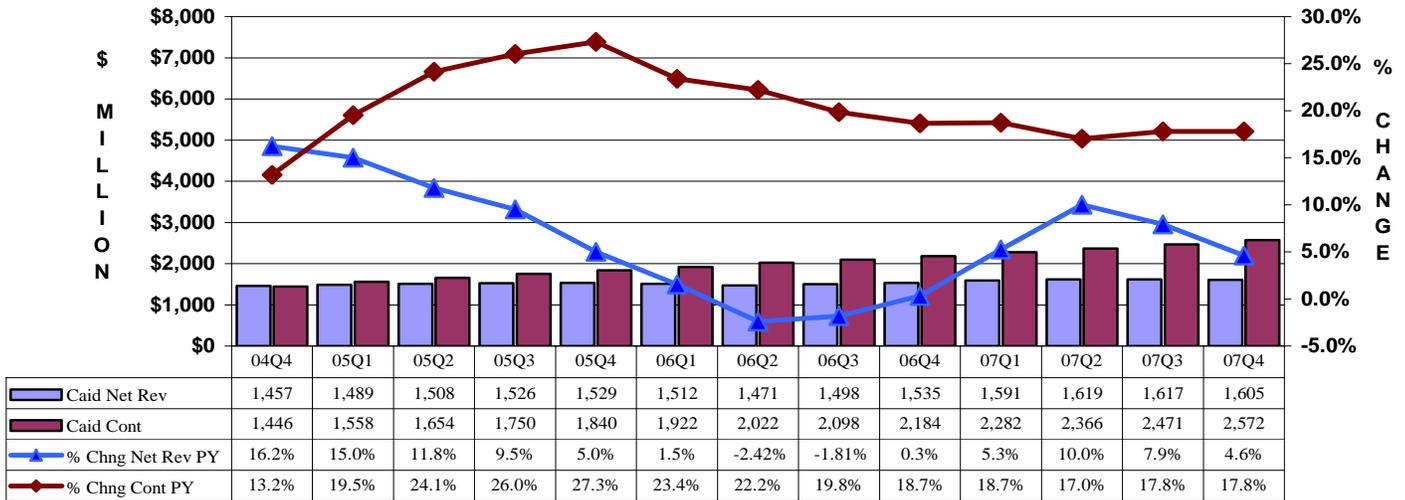
Contractuals, the most significant part of deductions from revenue, vary by payer. Below are three graphs, one for each payer, Medicare, Medicaid and Other. The three graphs are set up so you can see the relative size of the contractual adjustments and the net revenue by payer. The chart shows net revenue and contractuals and the percentage change for each over the prior year period. Other payer has the largest portion of net revenue, \$7.37 billion and deductions of \$6.17 billion. Medicare's net revenue of \$3.84 billion is much less than other however the contractuals are similar to other at \$5.91 billion. Medicaid net revenue was \$1.61 billion and deductions were \$2.57 billion. Based on the hospital's rate sheet, or billed revenue, hospitals

bill Medicare an average of \$2.54 for each dollar they receive, other payers an average of \$1.84 and Medicaid an average of \$2.60.

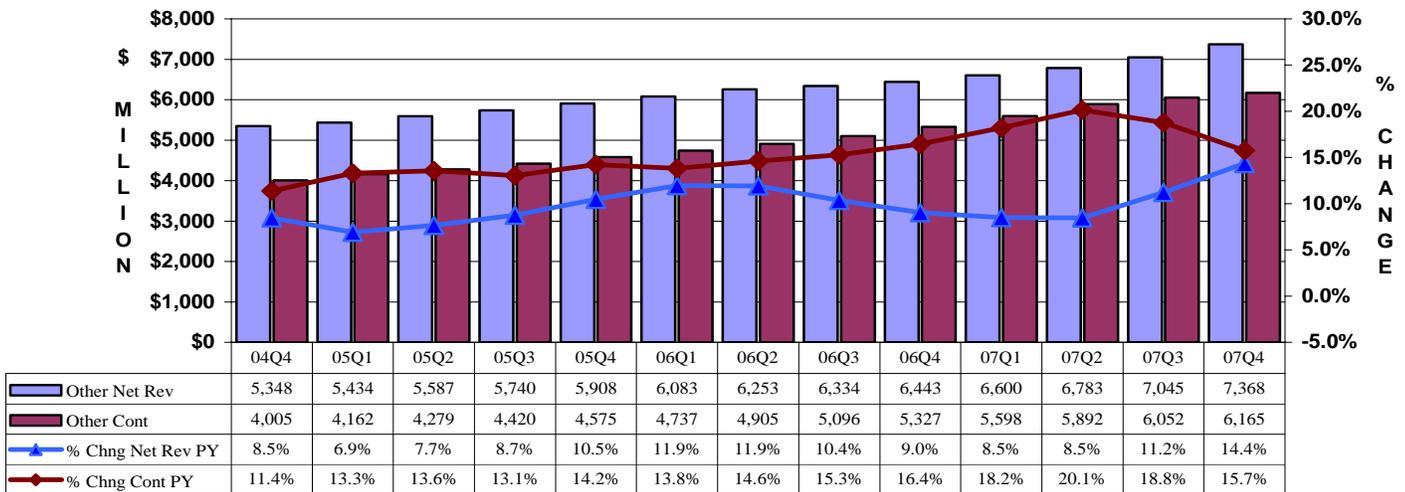
### Medicare Contractuals



### 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 17.6% and bad debt has increased by 19.1%, for a total increase in uncompensated care of 18.4%.

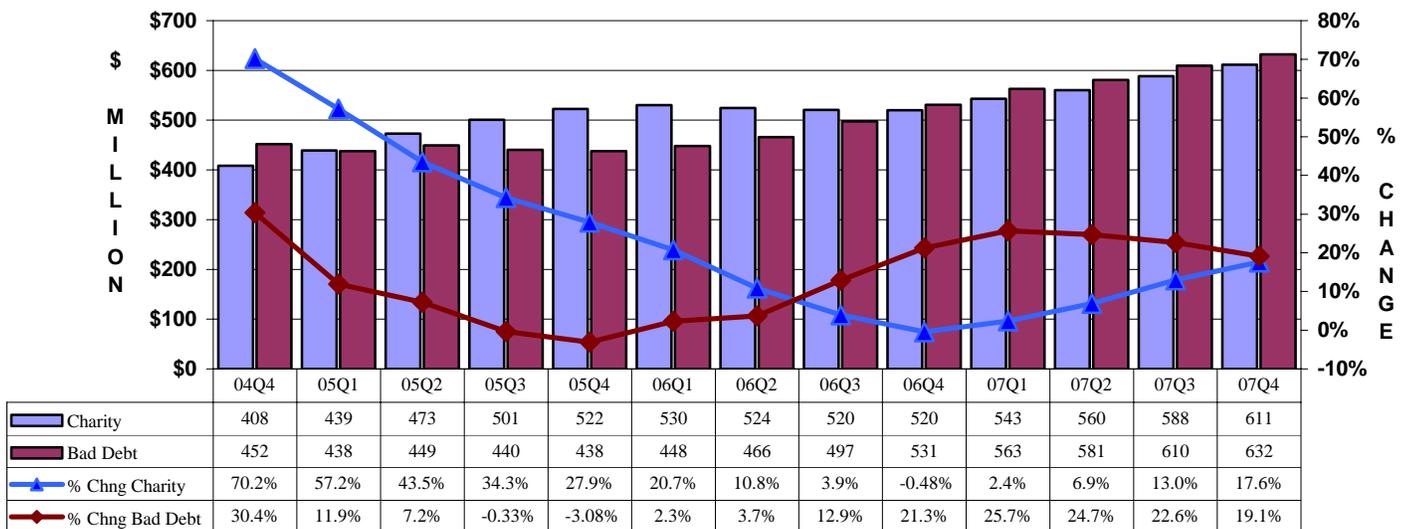
### Charity

While charity care is only 2.23% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. Recently, during the December 31, 2006 to December 31, 2007 period, charity care has increased 17.6% or \$91 million. The rate of increase in charity care had been generally declining from the fourth quarter of 2003 to the fourth quarter of 2006, although the past four quarters have seen increases in that rate.

### Bad Debt

The bad debt dollar amount has grown from \$531 million for the four quarters ending December 31, 2006 to \$662 million for the period ending December 31, 2007 which is a 19.1% 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.

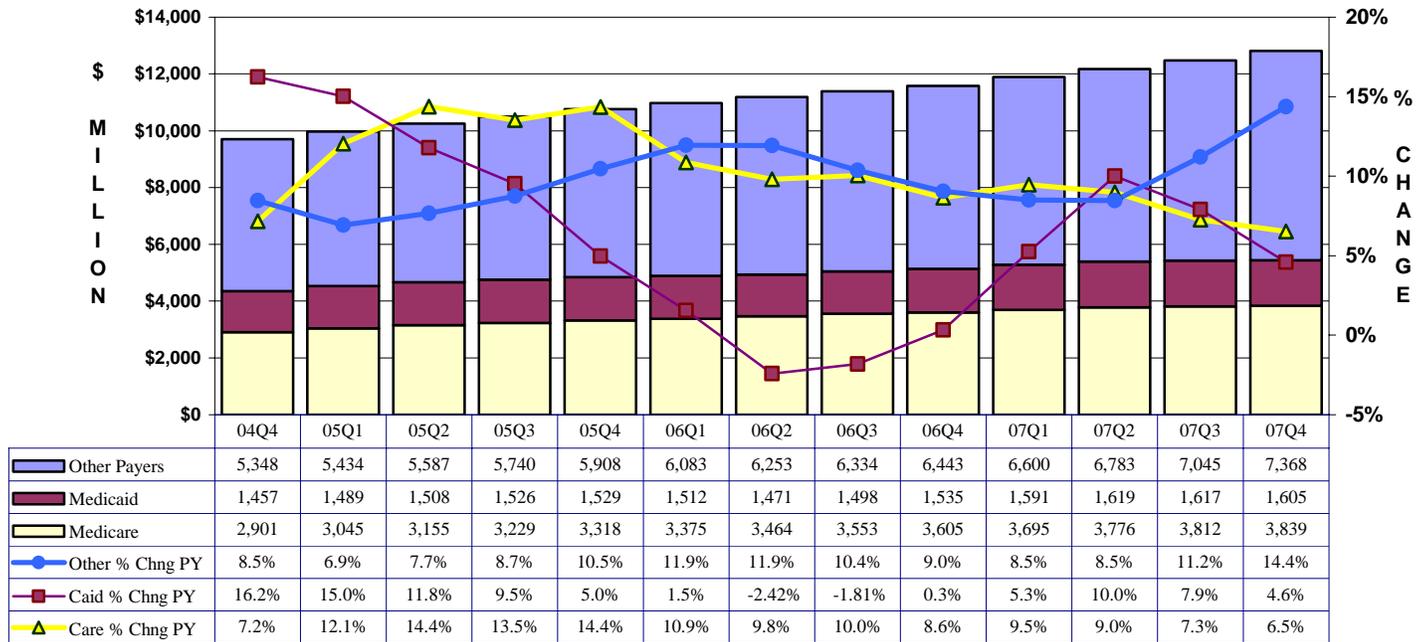
### Charity and Bad Debt



### Net Patient Services Revenue

During the twelve month period ended December 31, 2006 net patient service revenue grew by 10.3%, or \$1.1 billion, from \$11.1 billion to \$12.2 billion. Other payer continues its strong percentage and dollar growth (14.4%, \$925 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 6.5% increase and other had a 14.4% increase over the twelve month period ending December 31, 2006. Medicaid revenue increased 12.3% while Medicaid deductions increased by 17.8%, increasing the net patient service revenue for Medicaid by 4.6% from the previous period.

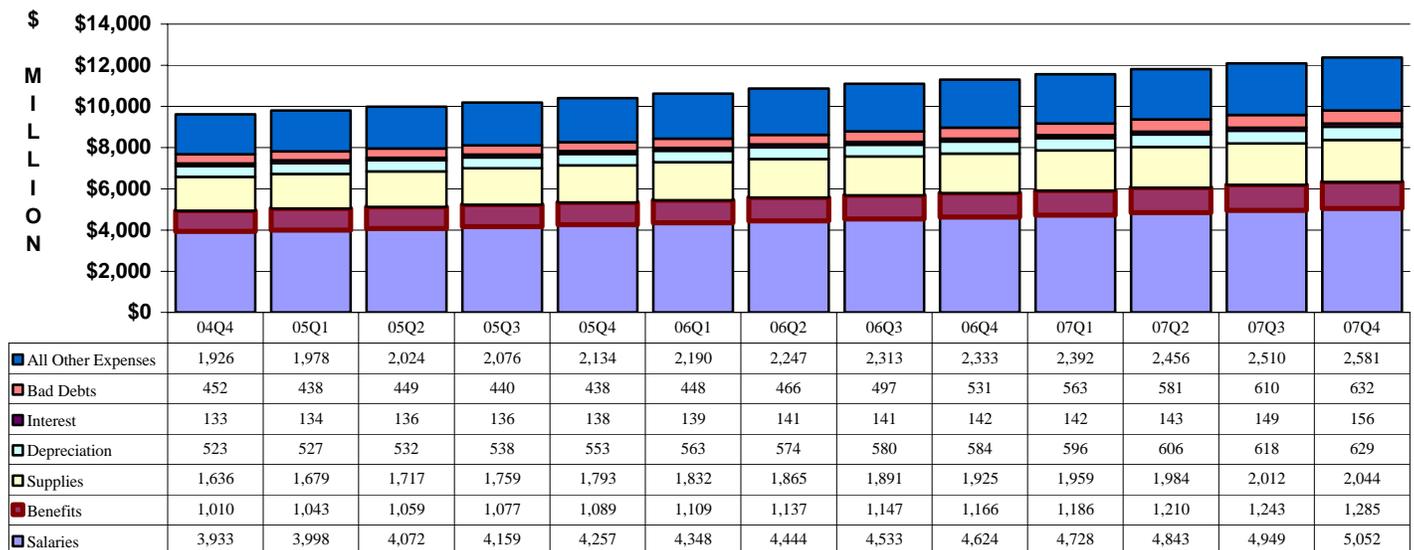
## Net Patient Service Revenue by Payer



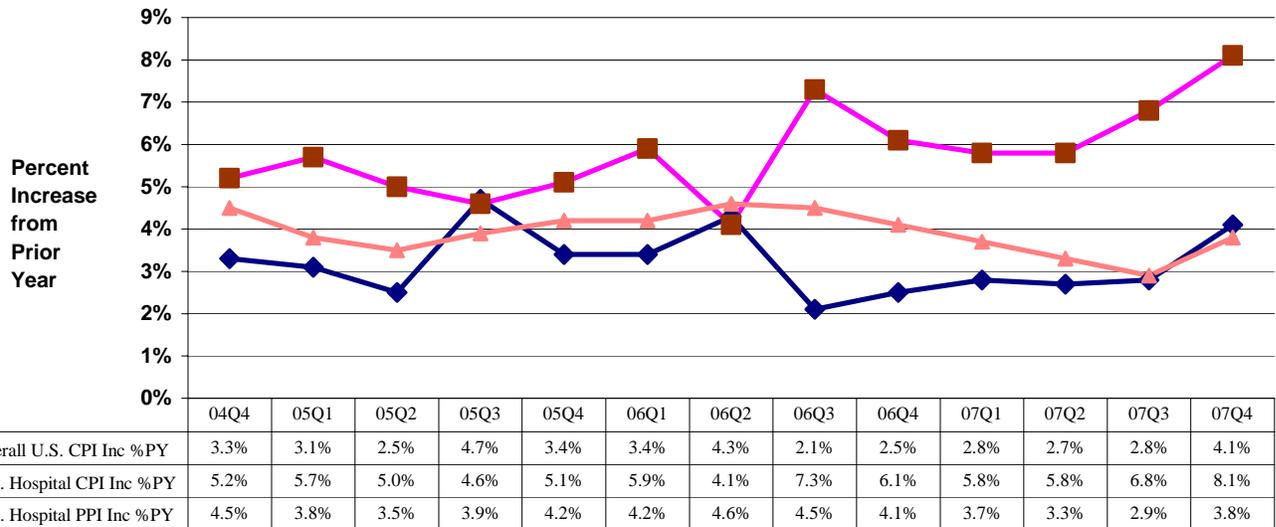
## Operating Expenses

Operating expenses are the costs of providing health care services to hospital patients. Growing by 9.5%, or \$1.08 billion, operating expenses reached \$12.38 billion in the twelve month period ended December 31, 2007. Adjusted discharges only increased 1.0% during the same time period. Operating expenses per adjusted discharge increased by 8.43%. The 8.43% increase exceeded the 4.1% annual increase in the overall United States consumer price index as well as the 8.1% annual increase in the United States hospital services component of the index for the same time period of December 2006 to December 2007. The category with the largest dollar increase in operating expenses was salaries at 9.3% or \$429 million for a total of \$5,052 million. The category with the largest percentage increase in operating expenses was bad debt at 19.1%, or \$101 million for a total of \$632 million. Interest expense had the smallest dollar increases during the same period, while supplies had the smallest percentage increase.

## Operating Expense



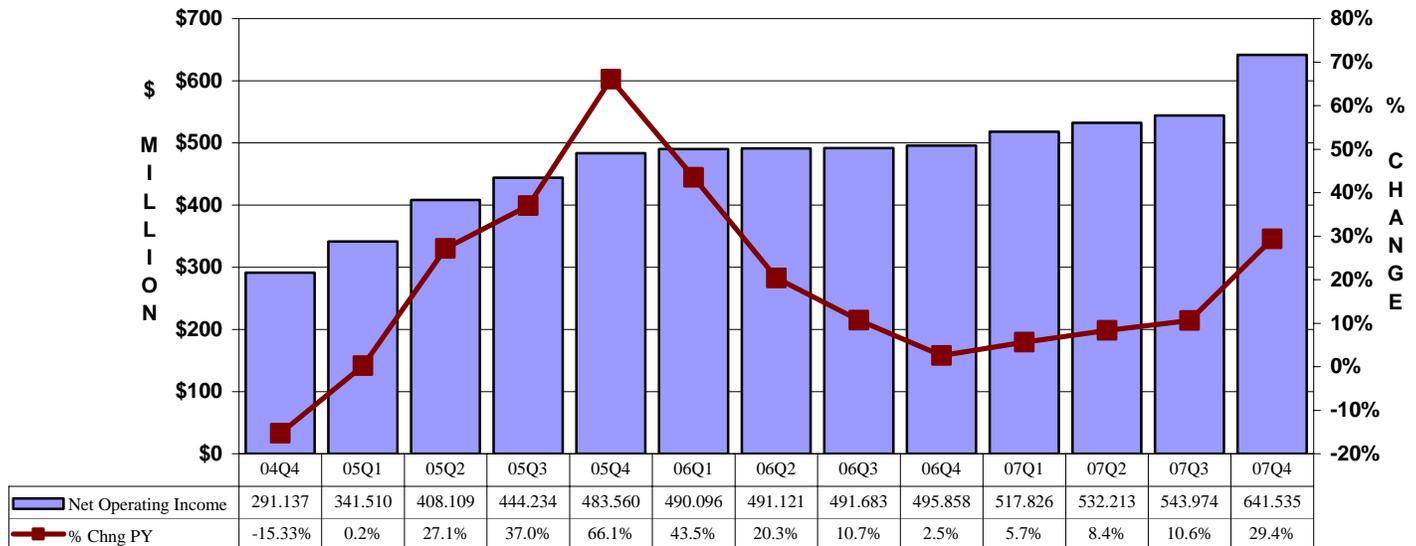
## United States Consumer Price Index and Produce Price Index change from previous year (Overall vs. Hospital)



### Net Operating Income

During the four quarters ended December 31, 2007 net operating income advanced to \$642 million, which was up 29.4% over the year ago level. This is the highest rate of growth since the year ending March 31, 2006. 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 10.3% and operating expense, which grew 9.5%, caused the 29.4% change in net operating income. Net operating income includes other operating income.

### Net Operating Income

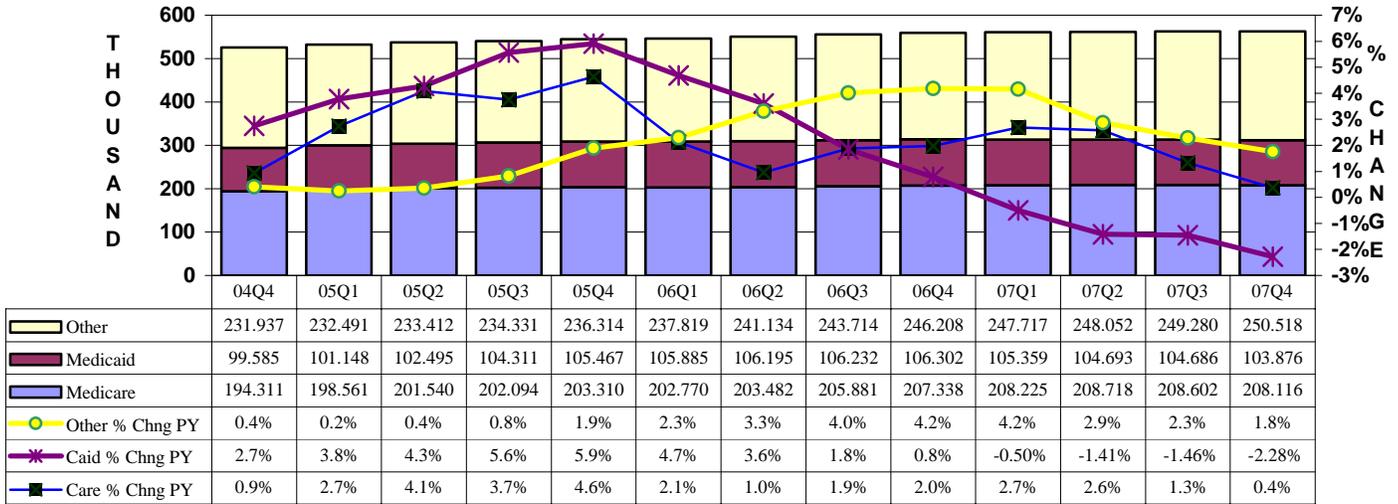


## UTILIZATION INDICATORS

### Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow slowly, reaching a total of 562,510 discharges during the four quarters ending December 31, 2007. This was a gain of only 2,662 discharges, or .5%, over the corresponding 2006 period. Medicaid discharges decreased 2.28%, while Medicare discharges increased 0.4% and other discharges increased 1.8%.

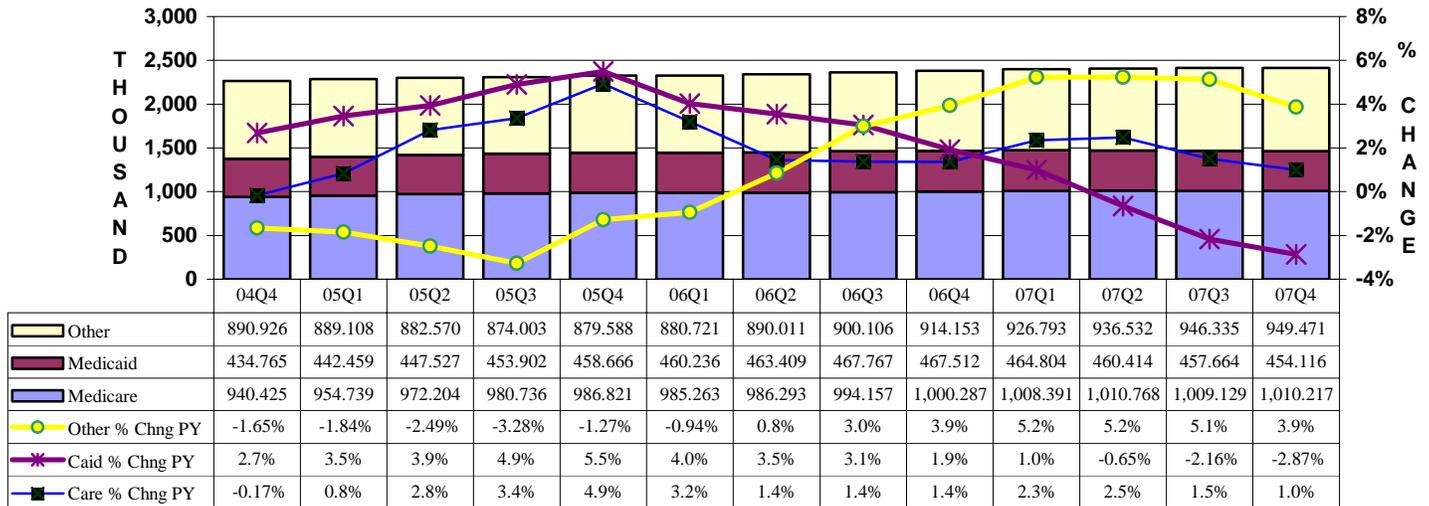
## Discharges by Payer



## Patient Days

Patient days also continued to grow modestly, reaching a total of 2,413,804 during the four quarters ending December 31, 2007. This was a gain of 31,852 patient days, or 1.3%, over the corresponding year ago period. Medicare days grew 1.0%, Medicaid days declined 2.87% and other increased by 3.9%.

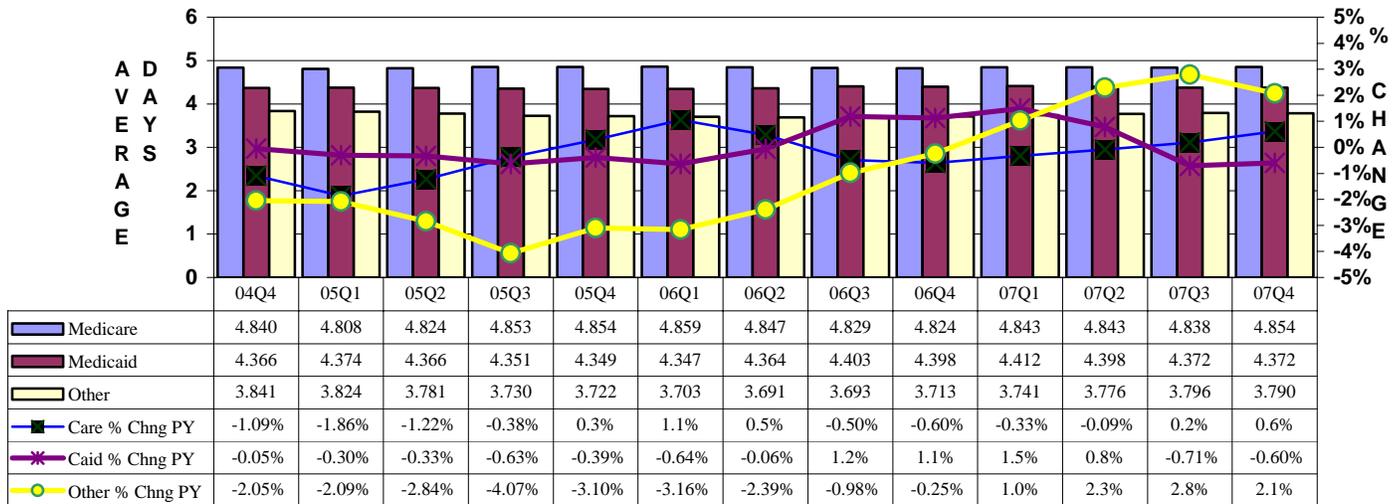
## Patient Days by Payer



## Length of Stay

Since the percentage increase in statewide discharges during the four quarters ending December 31, 2007 was less than the increase of patient days, statewide average length of stay increased slightly to 4.29 days, or 0.9%. 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 December 31, 2007 the average length of stay has increased by .04 days from the previous period ending December 31, 2006. In the latest period, Medicare average length of stay was 4.85, Medicaid was 4.37 and other was 3.79. Medicare ALOS was 11% higher than Medicaid and 28.1% higher than other payer.

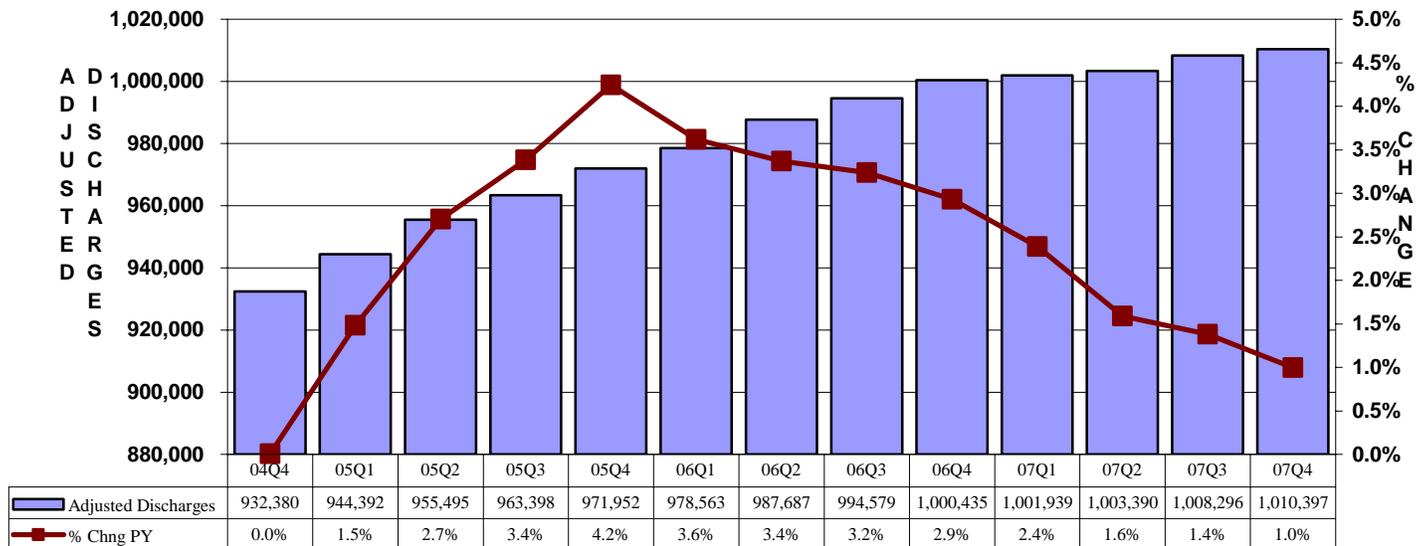
## Length of Stay by Payer



## Adjusted Discharges

Adjusted discharges reached a total of 1,010,397 in the four quarter period ended December 31, 2007. This was an increase of only 9,961 adjusted discharges, or 1.0%, from the four quarter period ended December 31, 2006. 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

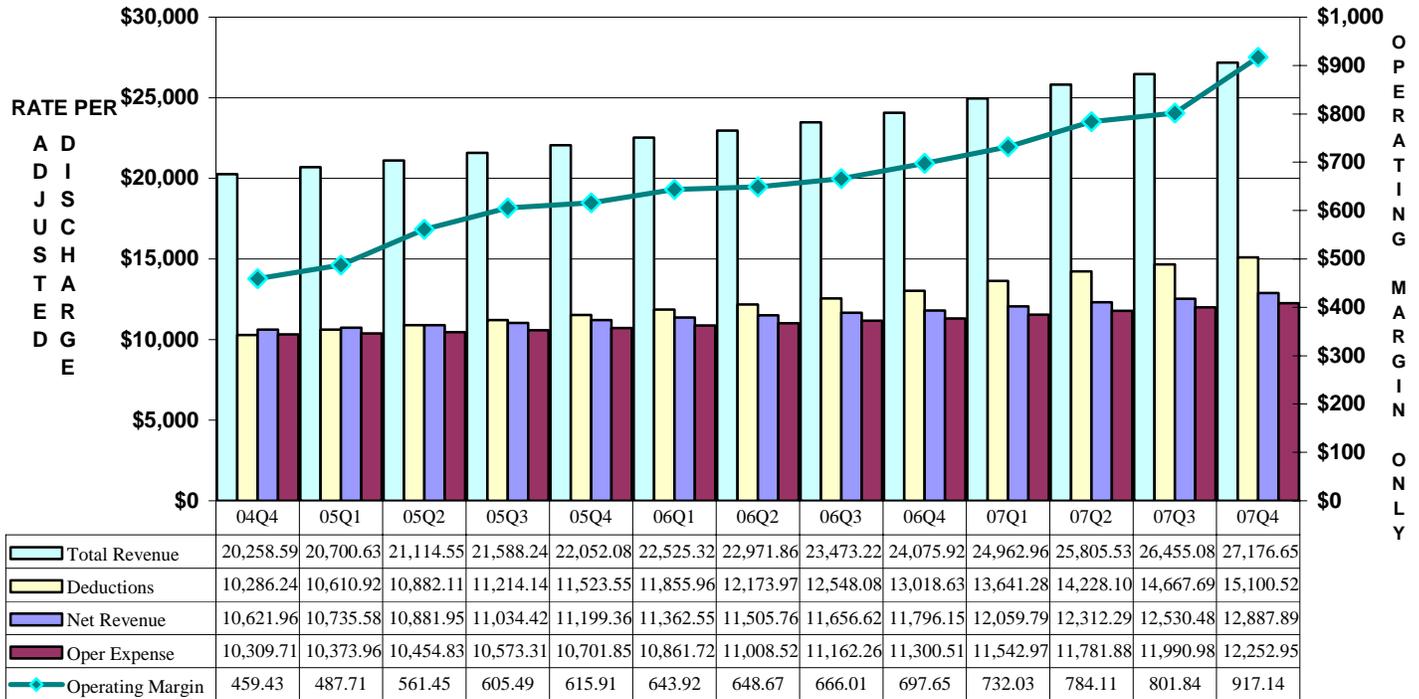


## OPERATING INDICATORS

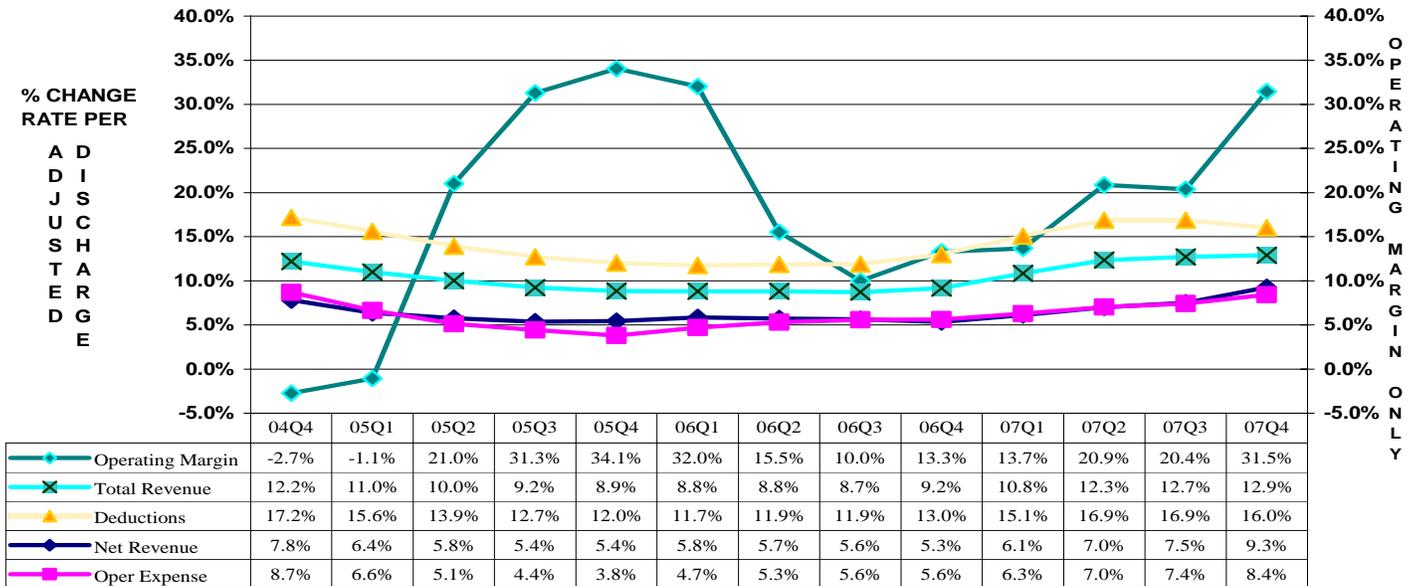
### Rates per Adjusted Discharge

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



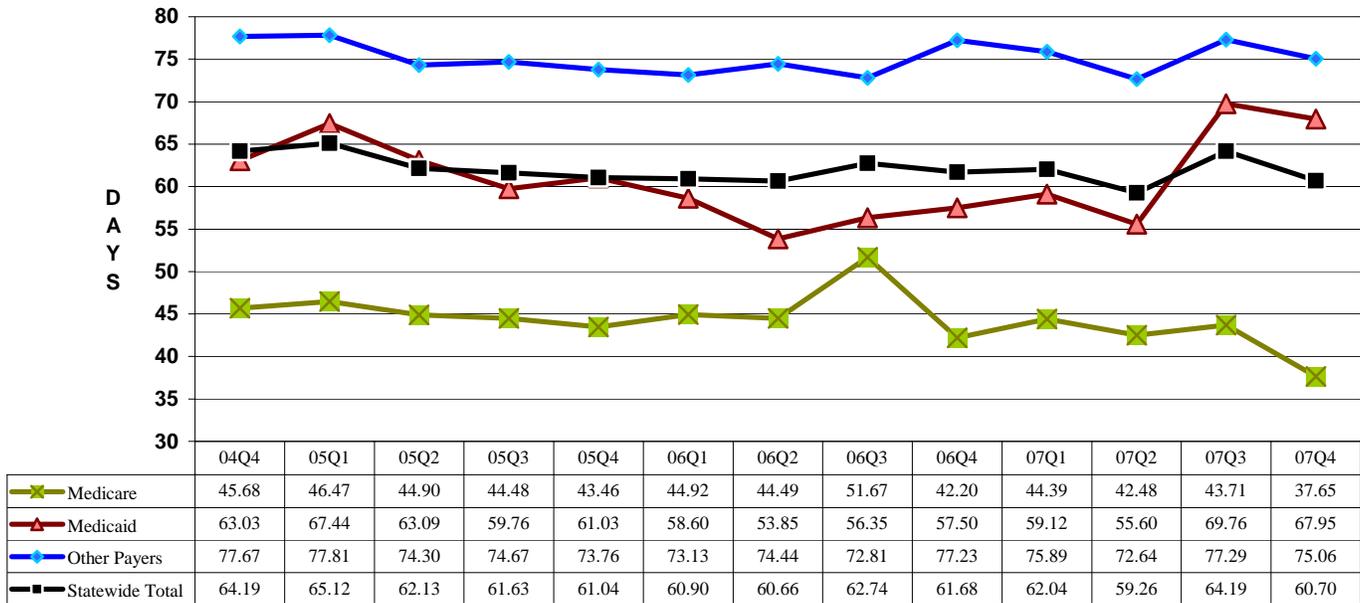
## FINANCIAL RATIOS

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 60.7 days for the four quarter period ending December 31, 2007. This was decrease of 3.49 days, or 1.59%, from the corresponding year earlier period. Medicare accounts receivable decreased by 4.5 days, or 10.77%, to 37.65 days. Accounts receivable for Medicaid increased by 10.5 days, or 18.18%, to 67.95 days. A decrease of 2.2 days, or 2.8%, to an average of 75.1 days was also noted for the other payer groups.

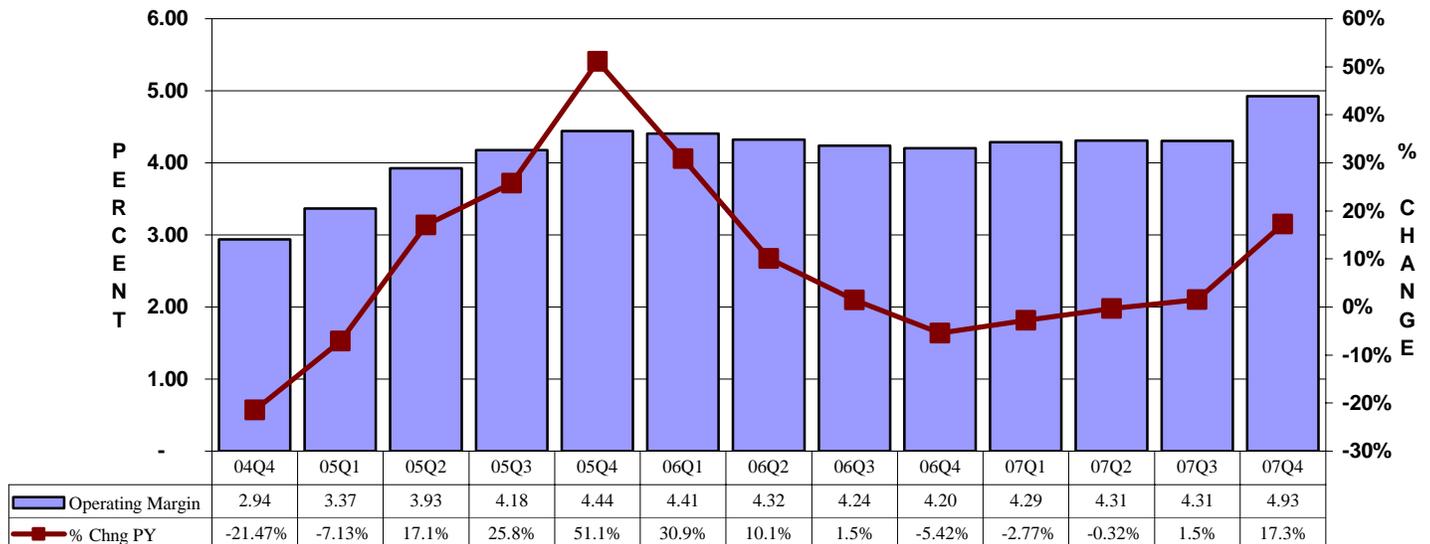
## Days in Accounts Receivable by Payer



## Operating Margin

During the twelve month period ended December 31, 2007 operating margin reached 4.93%, which was 17.25% above the year earlier level. The current period is higher than any period since the four quarters ending March 31, 1991. Operating margin includes patient revenue and other operating revenue.

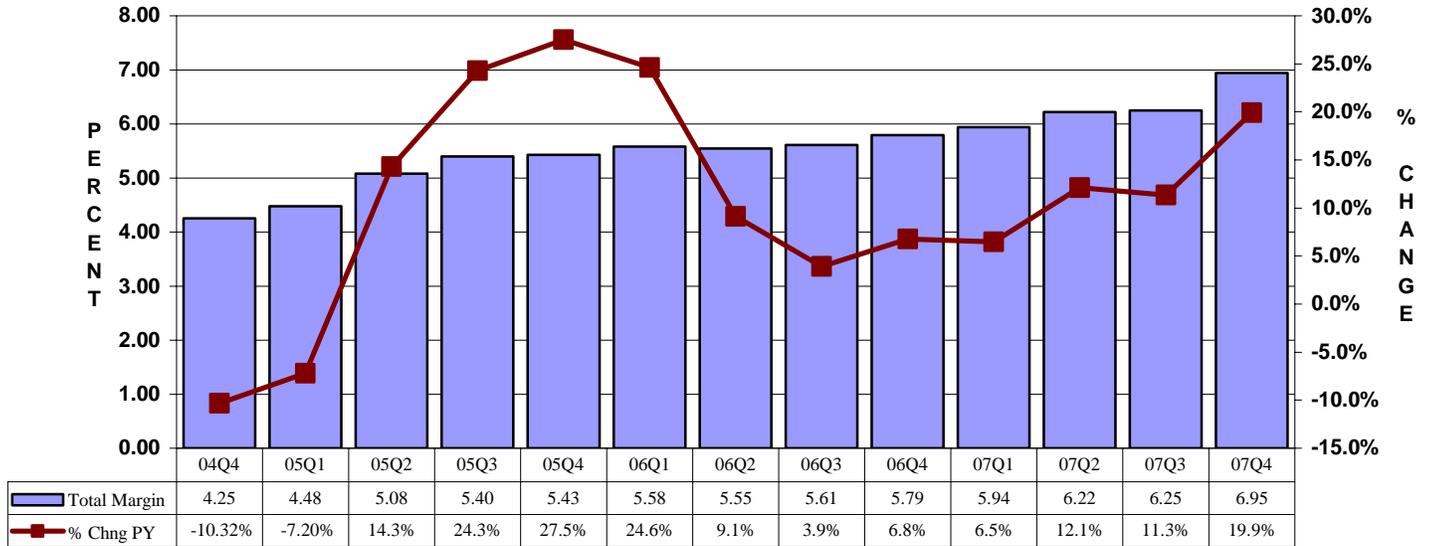
## Operating Margin



## Total Margin

During the twelve month period ending December 31, 2007 operating margin reached 6.95%, which was 19.9% 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

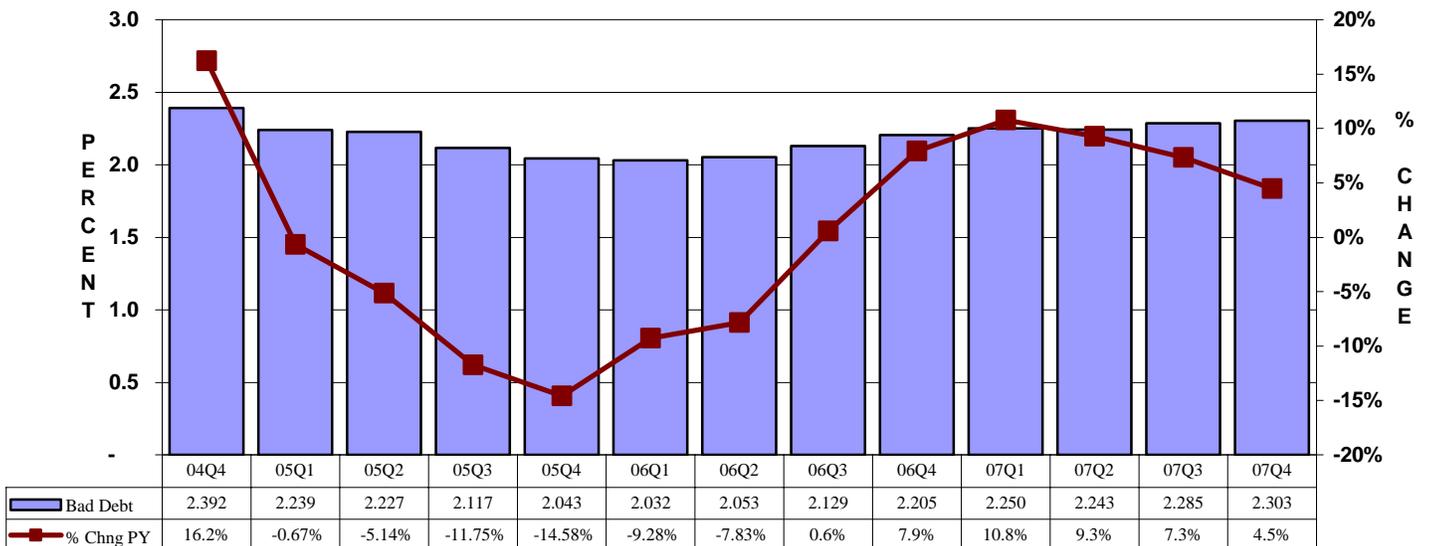
### Uncompensated Care Proportion

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 4.53%, which was an increase of 3.82% over the previous year.

### Bad Debt

In the four quarter period ended December 31, 2007, the bad debt proportion reached 2.30%, which was an increase of 4.46% from the previous year.

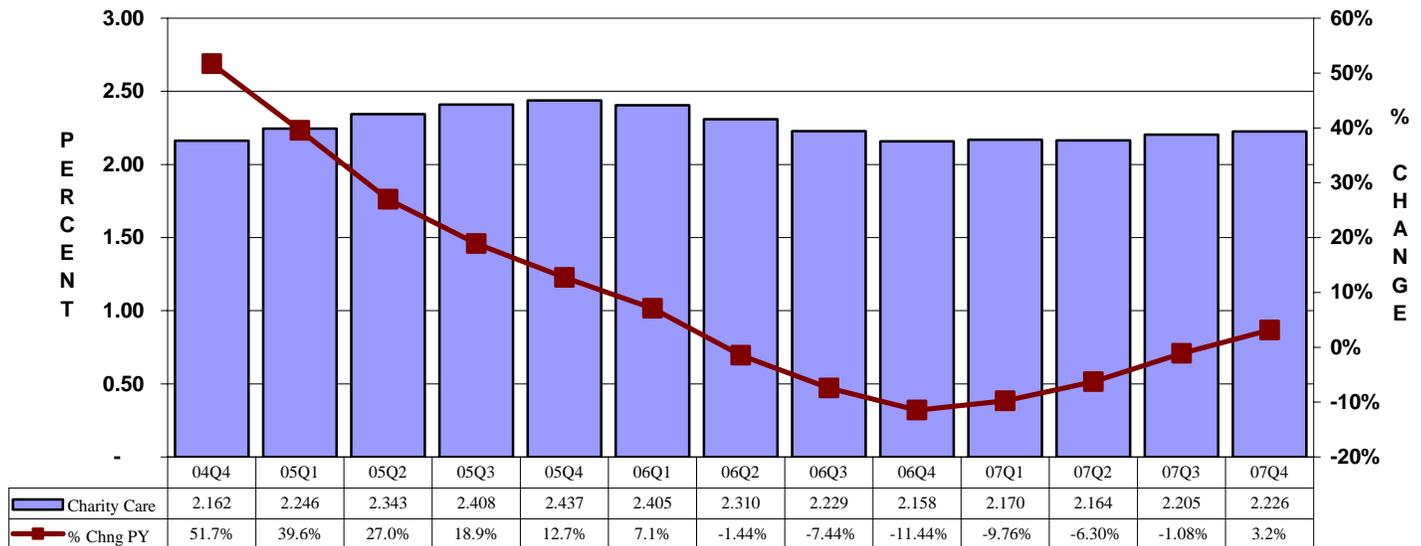
### Bad Debt as a Percent of Total Revenue



## Charity Care

The charity care proportion reached 2.23%, which was an increase of 3.16% from the previous year. This reversed a six consecutive quarter decline in this proportion.

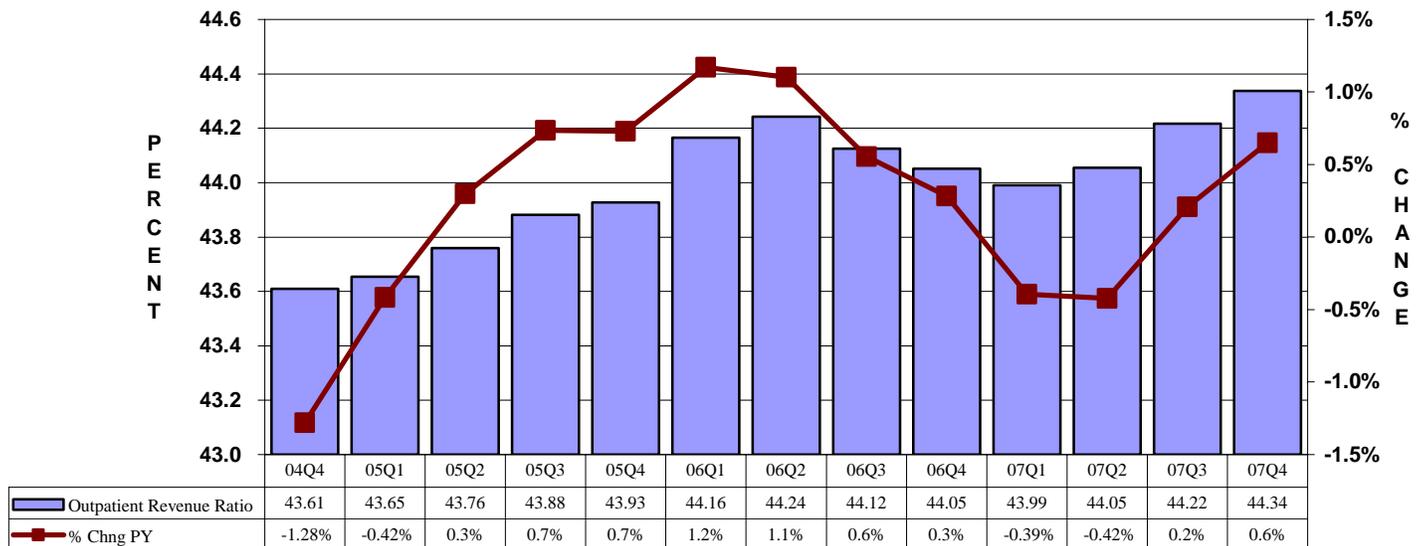
### Charity Care as a Percent of Total Revenue



## 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 December 31, 2006 and December 31, 2007 the outpatient revenue percentage increased from 44.05% to 44.34%, or 0.65%. 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.

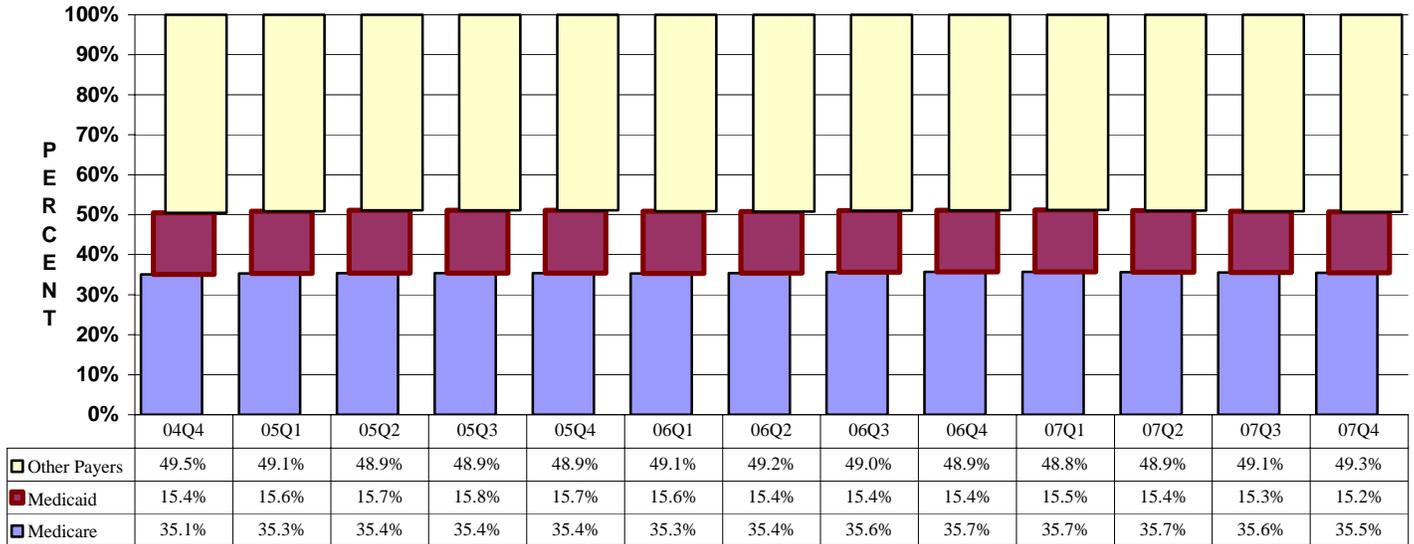
### Outpatient Revenue as a percent of Total Revenue



## 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 December 31, 2007 the Medicare percentage was 35.50%, a decrease of .20% 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 50.71% 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 December 31, 2006	12 Mo. Ended December 31, 2007	Total Change	Percent Change
<b>Total Patient Revenue</b>				
Inpatient	13,478,855,822	15,287,139,088	1,808,283,266	13.42%
Outpatient	10,610,404,722	12,174,657,584	1,564,252,862	14.74%
Total	24,089,260,544	27,461,796,672	3,372,536,128	14.00%
Medicare	8,597,931,149	9,748,050,441	1,150,119,292	13.38%
Medicaid	3,718,441,278	4,177,463,655	459,022,377	12.34%
Other	11,770,027,307	13,533,681,487	1,763,654,180	14.98%
<b>Deductions From Revenue</b>				
Contractual Adjustments				
Medicare	4,993,385,441	5,908,594,457	915,209,016	18.33%
Medicaid	2,183,884,041	2,572,306,833	388,422,792	17.79%
Other	5,327,256,599	6,165,306,920	838,050,321	15.73%
Total	12,504,526,081	14,646,208,210	2,141,682,129	17.13%
Charity	519,769,180	611,301,148	91,531,968	17.61%
Total	13,024,295,261	15,257,509,358	2,233,214,097	17.15%
<b>Uncompensated Care</b>				
Bad Debt	531,035,758	632,369,546	101,333,788	19.08%
Charity	519,769,180	611,301,148	91,531,968	17.61%
Total	1,050,804,938	1,243,670,694	192,865,756	18.35%
<b>Net Patient Revenue</b>				
Medicare	3,604,545,708	3,839,455,984	234,910,276	6.52%
Medicaid	1,534,557,237	1,605,156,822	70,599,585	4.60%
Other	6,442,770,708	7,368,374,567	925,603,859	14.37%
Total	11,064,965,283	12,204,287,314	1,139,322,031	10.30%
<b>Other Operating Revenue</b>	739,179,675	820,190,942	81,011,267	10.96%
<b>Total Operating Revenue</b>	11,804,144,958	13,024,478,256	1,220,333,298	10.34%
<b>Total Operating Expenses</b>	11,305,426,471	12,380,342,242	1,074,915,771	9.51%
<b>Net Operating Income</b>	498,718,487	644,136,014	145,417,527	29.16%
<b>Non-Operating Income</b>	168,363,105	249,508,101	81,144,996	48.20%
<b>Tax Revenue</b>	30,874,806	33,031,168	2,156,362	6.98%
<b>Net Total Income</b>	697,956,398	926,675,283	228,718,885	32.77%
<b>Gross Accounts Receivable</b>				
Medicare	994,079,920	1,005,624,973	11,545,053	1.16%
Medicaid	585,731,567	777,681,267	191,949,700	32.77%
Other	2,490,472,987	2,782,955,193	292,482,206	11.74%
Total	4,070,284,474	4,566,261,433	495,976,959	12.19%
<b>Days in Accounts Receivable</b>				
Medicare	42.2	37.7	(4.5)	-10.77%
Medicaid	57.5	67.9	10.5	18.18%
Other Payers	77.2	75.1	(2.2)	-2.82%
Statewide Total	61.7	60.7	(1.0)	-1.59%
<b>Utilization</b>				
Discharges	559,848	562,510	2,662	0.48%
Patient Days	2,381,952	2,413,804	31,852	1.34%
Length of Stay	4.25	4.29	0.04	0.86%
Adjusted Discharges	1,000,435	1,010,397	9,961	1.00%
<b>Rates per Adjusted Discharge</b>				
Total Revenue	24,078.78	27,179.23	3,100.45	12.88%
Deductions	13,018.63	15,100.52	2,081.89	15.99%
Net Revenue	11,799.01	12,890.46	1,091.45	9.25%
Operating Expense	11,300.51	12,252.95	952.45	8.43%
Net Margin	697.65	917.14	219.49	31.46%
<b>Financial Ratios</b>				
Operating Margin	4.20	4.93	0.72	17.25%
Total Margin	5.79	6.95	1.15	19.91%
Deductible Proportion	54.07	55.56	1.49	2.76%
Contractual Proportion - Total	51.92	53.34	1.42	2.74%
Contractual Proportion - Medicare	58.08	60.61	2.54	4.37%
Contractual Proportion - Medicaid	58.73	61.58	2.84	4.84%
Contractual Proportion - Other	45.26	45.56	0.29	0.65%
Bad Debt Proportion	2.20	2.30	0.10	4.46%
Charity Proportion	2.16	2.23	0.07	3.16%
Uncompensated Care Proportion	4.36	4.53	0.17	3.82%
Total Revenue/Inpatient Revenue	1.79	1.80	0.01	0.52%
Outpatient Revenue Percent	44.05	44.34	0.29	0.65%
Medicare Revenue Percent	35.70	35.50	(0.20)	-0.55%
Medicaid Revenue Percent	15.44	15.21	(0.22)	-1.45%

## 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 all four 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 December 31, 2007

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