

Health Care Compliance Association

Audit & Compliance Committee Conference

Introduction to Healthcare Accounting

May 20, 2010



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Agenda

- Industry Overview
- Industry Trends
- Healthcare Financial Reporting
- Key Financial and Operational Performance Metrics

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Industry Overview

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Industry Overview

How Teaching Hospitals Differ from Community Hospitals

Distinguishing factors of academic medical centers:

- Tripartite mission
- Size and location
- More complex cost structure
- Greater capacity constraints and infrastructure costs
- Diversity of services provided
- Level of uncompensated care provided

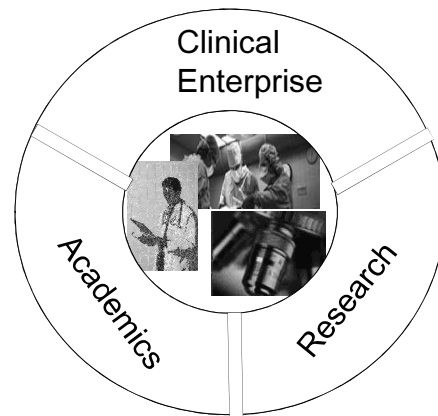
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Industry Overview
Tripartite Mission of an AMC

AMCs have **three missions**:

- Clinical care
- Academics / education
- Research



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Industry Overview
AMC Cost Structure vs. Community Hospitals

- Comprehensive tripartite mission introduces competing needs for funding and capital investment
- Rising cost of medical care at AMCs due in part to:
 - Greater case mix intensity compared to community hospitals
 - Development of new cutting-edge technology and advances in medicine
 - Greater staff ratios due to teaching model of care
 - Increasing costs of professional liability insurance
- Cost pressures created by urban location and greater proportion of uncompensated care
- Increased importance of being able to negotiate favorable reimbursement rates for complex cases

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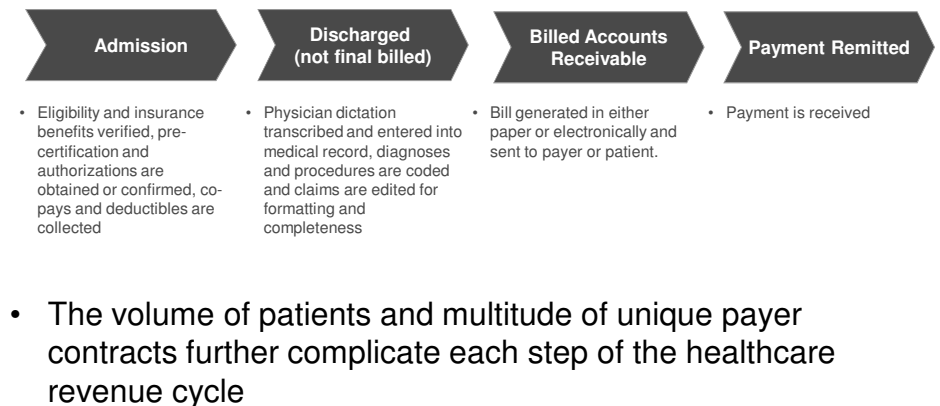
Industry Overview Greater Capacity Constraints and Infrastructure Costs

- Greater instances of capacity constraints caused by:
 - Overcrowded emergency departments (EDs) due to uninsured using ED as source of primary care
 - Greater occupancy rates, average length of stay and outpatient visits due to ability to serve more complex and diverse cases
- Continuous pressure to balance research, teaching and clinical space requirements for AMCs
- Limited access to capital as well as decline in charitable giving have curbed expansion plans and construction initiatives

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Industry Overview Healthcare Revenue Cycle



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Industry Overview Compare Payer and Payment Methodology

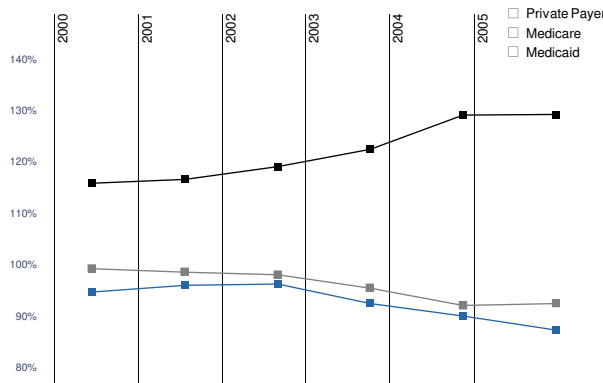
Payer	Payment Methodology	
	Inpatient Care	Outpatient Care
Medicare	Prospective Payment System based on DRGs (per case)	Prospective Payment System based on Ambulatory Payment Classifications (APCs)
Medicaid	Each state establishes its own methodology (per diem)	Each state establishes its own methodology
Managed Care / Commercial Insurance	Contracted rates in the form of per diems, per case or discounted charges	Contracted rates in the form of per visit or discounted charges
Self-pay and Other	Typically charges or discounted charges	Typically charges or discounted charges

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Industry Overview Reimbursement to Cost Ratios

Aggregate Hospital Payment to Cost Ratios



Changes to healthcare industry that could impact these ratios:

- Pay for performance and increased reliance on government payment
- Changes in uncompensated care funding
- Medical malpractice reform
- Health IT
- Healthcare Reform

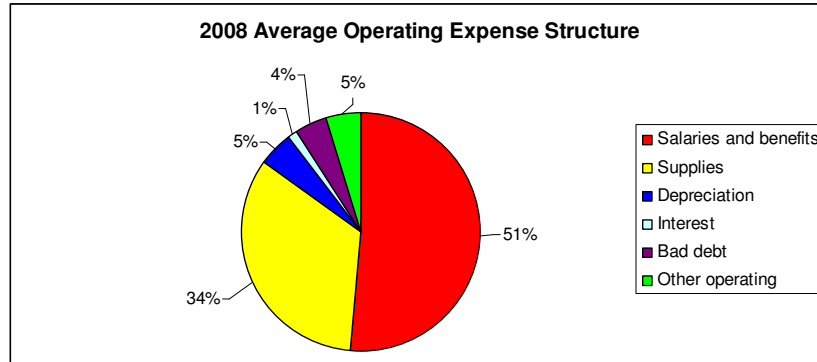
- Location and payer mix of hospital are substantial drivers of profitability
- Current economic environment presents further challenges in negotiating annual reimbursement increases with private insurers

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Industry Overview
Cost Environment

Salaries and benefits expense represented approximately 50% of average hospital operating expenses:



Industry Overview
Recruitment and Retention of Clinical Staff

- Adequately staffed and well-trained clinical employees are more important than ever
- Attracting top quality physicians is critical to profitability
- Nursing shortages have led to increased usage of temporary staff – although the trend may be reversing in current economic environment
- Extent of union participation can impact flexibility in implementing different employment and benefit strategies
- Current rise in unemployment may help ease pressure in identifying administrative or clerical resources

Industry Trends

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Industry Trends Impact of the Current Economy

- Declining operating margins
 - State and Federal spending cuts (including health reform)
 - Decreases in patient volume as patients defer care and shift to outpatient settings
 - Increase in un/underinsured patients – growth in bad debt and charity care
- Strain on raising capital
 - Limited access to new capital
 - Declines in investment return
 - Declines in charitable giving
 - Additional pension funding requirements
- Administrative and clerical labor shortages may ease
- Financial distress can be ideal climate for innovation and cost cutting
- Higher emphasis on delivering value and service
- Increased consolidation activity

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Industry Trends Government Role

- Impact of the government on healthcare reimbursement
 - Including Medicare, Medicaid, and federal employers, the government is the purchaser for more than half of all healthcare
 - Currently nearly one in four dollars spent on hospital services by private payers and employers pays for unpaid costs incurred by the uninsured, Medicare and Medicaid.

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Industry Trends Other Key Trends

- Increasing focus on quality and pay-for-performance
- Stringent patient privacy and security standards (HIPAA)
- Greater use of electronic health and medical records
- Significant regulatory oversight and demands for external reporting
 - Recovery Audit Contractor (RAC) and other CMS initiatives
 - New Form 990 and other tax considerations
 - Corporate compliance and OIG audits / investigations
 - Increasing oversight by state Attorneys General
 - National Institutes of Health (NIH) and other research requirements
 - Program accreditation
 - Donor intent

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Healthcare Financial Reporting

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Healthcare Financial Reporting

- Applicable “GAAP” includes the AICPA Audit and Accounting Guide, *Health Care Organizations*
- Unique characteristics of healthcare reporting
 - Statement of operations and the performance indicator
 - Net patient service revenue
 - Contractual allowances
 - Charity care and bad debt
 - Estimated settlements with third-party payers
- Requires the basic financial statements to include:
 - Balance sheet
 - Statement of operations
 - Statement of changes in net assets
 - Statement of cash flows
 - Notes to financial statements

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Healthcare Financial Reporting The Performance Indicator

- The statement of operations of not-for-profit healthcare organizations must report a performance indicator
- Must be clearly labeled with a term such as 'excess of revenues over expenses'
- Analogous to income from continuing operations of a for-profit enterprise
- Footnotes should include a description of the nature and composition of the performance indicator
- The performance indicator must be presented in a statement that also reports the total change in unrestricted net assets
- Paragraph 10.21 of the guide lists several items that must be reported separately from the performance indicator

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Healthcare Financial Reporting Net Patient Service Revenue (NPSR)

- NPSR is typically presented as one line in the statement of operations but includes the following components:

Gross patient service revenue	\$ 2,000
- provision for contractual allowances	(950)
+/- settlements with third-party payers	<u>(100)</u>
Net patient service revenue	<u>\$ 950</u>

- Gross patient service revenue (GPSR) is recorded on an accrual basis at the provider's established rates
- Information on GPSR is not as useful to financial statement users as NPSR and is typically not presented within the statements
- Footnote disclosures should include significant concentrations of credit risk resulting from major payers

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Healthcare Financial Reporting Contractual Allowances

- Most patient service revenues are received from third-party payers at contracted and usually reduced rates
- Provision for contractual allowances represents actual and estimated differences between established rates and third-party payer payments
- Contractual allowances are determined on a payer-by-payer basis and are recorded in the period when the services are provided as a deduction from GPSR and accounts receivable
- Methods of revenue recognition should be disclosed in the footnotes

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Healthcare Financial Reporting Charity Care

- Charity care
 - Represents healthcare services that are provided but payment is never expected to be collected (e.g., provided to a patient with a demonstrated inability to pay)
 - Does not qualify for recognition as a receivable or revenue
 - Management policy for providing charity care as well as the level of charity care provided should be disclosed in the footnotes

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Healthcare Financial Reporting Bad Debt

- Bad debt
 - Represents estimated portion of revenue and receivables that will not be paid
 - Provision for bad debt is presented separately within operating expenses
 - Patient accounts receivable are presented net of an allowance for bad debt; however, the allowance is either disclosed on the face of the balance sheet or in the footnotes

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Healthcare Financial Reporting Estimated Settlements with Third-Party Payers

- Under a retrospective reimbursement system, an entity may be entitled to receive additional payments or required to refund amounts received in excess of amounts earned under the system
- Although final settlements are not made until a subsequent period, they are usually reasonably estimable based on contract provisions or recent experience from audits, reviews or investigations
- Estimated settlements are reported as adjustments to GPSR and as a separate asset or liability on the balance sheet
- Changes to original estimates are reported as adjustments to GPSR and disclosed in the period the revisions are made

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Healthcare Financial Reporting Components of Revenue and Drivers

Inpatient:

- Price Drivers: 1. Payment Rates, 2. Case Mix, 3. Service Mix, 4. Payer Mix
- Volume Drivers: 1. Discharge and/or 2. Patient Day Changes

Outpatient:

- Price Drivers: 1. Payment Rates, 2. Service Mix, 3. Payer Mix
- Volume Drivers: 1. Visits (ER, Clinic and Ambulatory Surgeries)

3rd Party Reimbursement Revenue:

- Settlement changes
- Reserve adjustments

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Healthcare Financial Reporting Accounts Receivable Valuation Issues

- Billed and Unbilled Accounts Receivable
- Contractual allowance estimates (by payer)
 - Timing of contractual allowance recognition dictates need for allowance (e.g. typically IP at time billing and OP at time of payment)
 - Inpatient:
 - Inhouse
 - DNFB
 - Billed
 - Outpatient:
 - Unbilled
 - Billed (particular payers at net?)
- Bad Debt Reserve methodology and reserve %s

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Key Financial and Operational Performance Metrics

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Key Financial and Operational Performance Metrics

The following are common categories of metrics monitored by management and boards on a monthly or quarterly basis:

- Volume Statistics
- Revenue Cycle
- Productivity
- Quality Measures
- Financial Measures
- Capital Spending

Analyses should include review of trends over time as well as a comparison to budget

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Key Financial and Operational Performance Metrics Volume Statistics

- Discharges (by service and payer mix)
- Patient days (by service and payer mix)
- Case mix index (Medicare and total patients)
- Average length of stay (Medicare and total patients)
- Outpatient visits (may be difficult to compare across organizations)
- Observation cases
- Surgical procedures (inpatient and outpatient)

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Key Financial and Operational Performance Metrics Revenue Cycle

- Inpatient NPSR
 - Per discharge
 - Per patient day
- Outpatient NPSR
 - Per visit
- Payer mix and changes therein
- Receivables management
 - Cash collections (in total and as a % of NPSR)
 - Days revenue in patient receivables (net of contractual allowances)
 - % of receivables greater than 90 days
 - Denials / NPSR
 - Bad debt / NPSR

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Key Financial and Operational Performance Metrics Productivity

- Labor costs
 - Salaries per FTE
 - FTEs per occupied bed
 - Overtime and turnover percentages
- Non-labor costs (per patient day)
 - Medical supplies
 - Non-medical supplies
 - Drug costs

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Key Financial and Operational Performance Metrics Quality Measures

- Falls per 1,000 patient days
- Bloodstream infections
- Patient satisfaction (likelihood to recommend)
- Perioperative mortality
- Clinical delays
- Adherence to ACE-inhibitor therapy in heart failure
- Adherence to aspirin therapy in myocardial infarctions
- Readmission rates for pneumonia
- Medication errors with harm

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Key Financial and Operational Performance Metrics

Financial Measures

- Profitability (exclusive of non-recurring items)
 - Operating margin
 - Total margin (impacted by investment performance)
- Liquidity
 - Days cash on hand (should include unrestricted investments)
 - Current ratio (should include unrestricted long-term investments)
 - Average payment period
- Capital structure
 - Debt service coverage ratio (common debt covenant calculation)
 - Long-term debt to capitalization

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Key Financial and Operational Performance Metrics

Capital Spending

- Projects
- Timelines
- Issues
- Budgets
- Projections
- Life-to-date spending

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