A Primer on Ratio Analysis and the CAH Financial Indicators Report

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Agenda

1. The theory of financial analysis (p4)
2. Overview of the CAH Financial Indicators Report (p10)
3. Understanding and using the peer groups (p17)
4. Understanding and using the indicators (p31)
5. How hospitals can use the CAH Financial Indicators Report: An example (p59)
6. Benchmark Report (p77)
7. Market Report (p84)
8. Medicare Outpatient Report (p91)
1. The theory of financial analysis
Purpose

• One of the most important characteristics of a business is its *financial performance and condition*

• Financial analysis assesses a business’s financial performance and condition: Does it have the financial capacity to meet its mission?

• Results sometimes focus on financial *strengths* and *weaknesses*
Types of Financial Analyses

• Several types are used:
  – Financial statement analysis focuses on the information in a business’s financial statements with the goal of assessing financial condition
  – Operating indicator analysis focuses on operating data with the goal of explaining financial performance

• The CAH Financial Indicators Report includes financial statement and operating indicator analyses
Ratio Analysis

- Ratio analysis is a technique used in both financial statement and operating indicator analyses.
- It combines values from the financial statements (and elsewhere) to create single numbers that:
  - have easily interpretable financial significance
  - facilitate comparisons
Interpreting Ratios

• A single ratio value has little meaning:
  – One point in time that may not be representative
  – Can’t tell if it is better or worse than other hospitals

• Therefore, two techniques are commonly used to help interpret “the numbers”:
  – Trend (time series) analysis
  – Comparative (cross-sectional) analysis

• Both techniques are used in the CAH Financial Indicators Report
Using Ratios

- Ratios help to identify:
  - Questions to ask
  - Issues to address
  - Problems to solve

- Ratios do not necessarily provide
  - Answers
  - Explanations
  - Solutions
2. Overview of the CAH Financial Indicators Report
Objectives of the CAH Financial Indicators Report

• To select and construct a set of financial performance measures that are relevant to Critical Access Hospitals (CAHs)
• To provide comparative information that CAH boards and managements can use to improve financial performance
• To improve the quality of Medicare Cost Report data reported by CAHs (our goal)
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Report Produced: Summer 2014
Definitions: The formulae for the indicator in both conceptual and Medicare Cost Report format.

Recent Results for Your Hospital: A snapshot comparing your CAH to your peer group and state and national medians for the most recent year that data are available.

Results Over Time: A graphical and tabular comparison of your CAH to the national median over the past few years. The peer group and state medians for the most recent year are shown as an X and a box, respectively.

Data Quality/Exclusion Criteria: A description of the rules that were used to define whether a ratio is presented.

Interpretation: A description of how to interpret the indicator.
Ratios in the CAH Financial Indicators Report

• **Profitability** indicators measure the ability to generate the financial return required to replace assets, meet increases in service demands, and compensate investors
  – Total margin, cash flow margin, return on equity, operating margin

• **Liquidity** indicators measure the ability to meet cash obligations in a timely manner
  – Current ratio, days cash on hand, net days revenue in accounts receivable
• **Capital structure** indicators measure the extent of debt and equity financing
  – Equity financing, debt service coverage, long-term debt to capitalization
• **Revenue indicators** measure the amount and mix of different sources of revenue
  – Outpatient revenues to total revenues, patient deductions, Medicare inpatient payer mix, hospital Medicare outpatient payer mix, hospital Medicare outpatient cost to charge, Medicare acute inpatient cost per day
• *Cost* indicators measure the amount and mix of different types of costs
  – Salaries to net patient revenue, average age of plant, FTEs per adjusted occupied bed, average salary per FTE

• *Utilization* indicators measure the extent to which fixed assets (beds) are fully utilized
  – Average daily census swing-SNF beds, average daily census acute beds
3. Understanding and using the peer groups
In Summer 2004, hospital-specific reports were sent to 853 administrators.

An evaluation form was included.

Many respondents requested comparison of their performance to similar CAHs.
Selection of CAH Peer Groups

- Suggestions from respondents
- Literature review to identify important peer groups in other studies
- Advice of Technical Advisory Group
- Potential peer groups evaluated using statistical analysis
- Selected peer groups:
  - Important influences on indicator values
  - Could be validly defined from Cost Reports
Creation of CAH Peer Groups

• From Medicare Cost Report data, we identified factors important to CAH financial performance:
  – Had <$10 million, $10-20 million, or >$20 million in net patient revenue
  – Provided long-term care
  – Was owned by a government entity
  – Operated a Rural Health Clinic
Financial performance and condition varied significantly among the peer groups:

<table>
<thead>
<tr>
<th>Indicator</th>
<th># of Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net patient revenue</td>
<td>16 / 20</td>
</tr>
<tr>
<td>Provided long-term care</td>
<td>10 / 20</td>
</tr>
<tr>
<td>Owned by government</td>
<td>10 / 20</td>
</tr>
<tr>
<td>Operated a Rural Health Clinic</td>
<td>7 / 20</td>
</tr>
</tbody>
</table>
Creation of CAH Peer Groups

• All combinations of the four factors were used to create 24 peer groups
• Every CAH is assigned to one of the 24 peer groups
• Indicator medians are calculated for each peer group
In Summer 2005, hospital-specific reports were sent to 1,029 administrators.

- Peer group, state, and national medians
- Summary graph of performance relative to peer group
- An evaluation form was included and most respondents affirmed the selected peer groups
- Many wanted peer group comparisons for CAHs in their state
Net Patient Revenues

• Larger CAHs were more profitable and could carry more debt, possibly because:
  – More diagnostic and outpatient services
  – Higher charges, lower costs, or both
  – Lower proportion of Medicare patients
  – Higher patient volume generates higher total revenue and lower fixed costs per patient
  – Other reasons?
Net Patient Revenues

• Larger CAHs also had:
  – Higher Medicare revenue per day (greater patient acuity, ICU/specialty service, higher wages in larger communities?)
  – Lower salaries to total expenses (more equipment, higher drug costs?)
  – Newer average age of plant (greater debt capacity?)
Provided Long-Term Care

- CAHs that provided long-term care were less profitable, possibly because:
  - Higher proportion of Medicaid patients
  - Medicare Cost Report accounting methods
  - Lower patient volume
  - Other reasons?
• CAHs that provided long-term care also had:
  – Lower days revenue in accounts receivable (LTC bills submitted prior to service?)
  – Lower outpatient revenue to total revenue (LTC revenue is in the denominator)
  – Higher salaries to total expenses (high touch / low tech nature of long-term care?)
Owned by Government

• CAHs that were owned by the government were less profitable but more liquid, possibly because:
  – Higher charges, lower costs, or both
  – Lower patient volume
  – Other reasons?

• CAHs that were owned by the government also had:
  – Higher current ratio (lower use of debt)
  – Older average age of plant (lower use of debt?)
Operated a RHC

- CAHs that operated a RHC were less profitable, possibly because:
  - Higher proportion of Medicare inpatients
  - Lower patient volume
  - Other reasons?

- CAHs that operated a RHC also had:
  - Higher salaries to total expenses (physician compensation in numerator?)
Conclusion

• CAHs are not all the same - significant differences in financial performance and condition exist among CAH peer groups
• May be misleading or unfair to compare the financial performance of a smaller CAH to a larger CAH, a CAH that does not provide LTC to a CAH that provides LTC, and so on
• Compare CAH financial performance:
  – First to peer group median
  – Second to state median
  – Third to U.S. median
4. Understanding and using the indicators
An Example: Our Hospital

• Let’s look at indicator values for Our Hospital
• For all of the indicators:
  – Our Hospital is best performer
  – Peer group median is second best
  – State median is third best
  – U.S. median is fourth best
• All of the numbers are contrived except for the U.S median
### Profitability: Total Margin

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Margin</strong></td>
<td>6%</td>
<td>5%</td>
<td>4%</td>
<td>2.61%</td>
</tr>
</tbody>
</table>

**Definition**

Net income

Total revenue

**Interpretation**

Measures the control of expenses relative to revenues

*Is a higher total margin always good?*
## Profitability: Cash Flow Margin

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Flow Margin</td>
<td>8%</td>
<td>7%</td>
<td>6%</td>
<td>7.11%</td>
</tr>
</tbody>
</table>

**Definition**: Net income – (Contributions, investments, and appropriations + Depreciation expense + Interest expense) – Net patient revenue + Other income – Contributions, investments, and appropriations

**Interpretation**: Measures the ability to generate cash flow from providing patient care services

*Why might total margin be negative and cash flow margin be positive?*
## Profitability: Return on Equity

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Return on Equity</strong></td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
<td>5.36%</td>
</tr>
</tbody>
</table>

**Definition**

Net income

Net assets

**Interpretation**

Measures the net income generated by equity investment (net assets)

*What is net assets?*
### Profitability: Operating Margin

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin</td>
<td>3%</td>
<td>2%</td>
<td>1%</td>
<td>1.13%</td>
</tr>
</tbody>
</table>

**Definition**  
Net patient revenue + operating income – total operating expenses  
Net patient revenue + other revenue

**Interpretation**  
Measures the control of operating expenses relative to operating revenues  
*Is a higher operating margin always good?*
### Liquidity: Current Ratio

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>3.5</td>
<td>3.0</td>
<td>2.5</td>
<td>2.35</td>
</tr>
</tbody>
</table>

**Definition**

Current assets

Current liabilities

**Interpretation**

Measures the number of times short-term obligations can be paid using short-term assets

*Is a higher current ratio always good?*
## Liquidity: Days Cash on Hand

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>80 days</td>
<td>70 days</td>
<td>60 days</td>
<td>69.07 days</td>
</tr>
</tbody>
</table>

### Definition

\[
\text{Cash} + \text{temporary investments} + \text{investments} \\
\frac{(\text{Total expenses} - \text{Depreciation})}{\text{Days in period}}
\]

### Interpretation

Measures the number of days an organization could operate if no cash was collected or received

**How would you interpret 5 days cash on hand?**
## Liquidity: Days Revenue in Accounts Receivable

<table>
<thead>
<tr>
<th>Year</th>
<th>Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>40 days</td>
<td>45 days</td>
<td>50 days</td>
<td>52.74 days</td>
</tr>
</tbody>
</table>

### Definition

Net patient accounts receivable

(Net patient revenue) / Days in period

### Interpretation

Measures the number of days that it takes an organization to collect its receivables

**Is a higher days revenue in accounts receivable always bad?**
## Capital Structure: Equity Financing

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets/Total assets</td>
<td>68%</td>
<td>66%</td>
<td>64%</td>
<td>60.71%</td>
</tr>
</tbody>
</table>

**Definition**
- Net assets
- Total assets

**Interpretation**
- Measures the percentage of total assets financed by equity

*Is a higher equity financing always good?*
## Capital Structure: Debt Service Coverage

<table>
<thead>
<tr>
<th>Year</th>
<th>Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>6 times</td>
<td>5 times</td>
<td>4 times</td>
<td>2.52 times</td>
</tr>
</tbody>
</table>

### Definition

Net income + Depreciation + Interest expense
Notes and loans payable (short term) * (365/DIP) + Interest expense
where DIP means days in period

### Interpretation

Measures the ability to pay obligations related to long-term debt, principal payments and interest expense

*What happens if a hospital has no debt?*
## Capital Structure: Long-Term Debt to Capitalization

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term debt</td>
<td>18%</td>
<td>19%</td>
<td>20%</td>
<td>17.26%</td>
</tr>
</tbody>
</table>

**Definition**

Long-term debt

Long-term debt + Net assets

**Interpretation**

Measures the percentage of total capital that is debt

*Is a lower long-term debt to capitalization always good?*
## Revenue: Outpatient Revenues to Total Revenues

<table>
<thead>
<tr>
<th>Year</th>
<th>Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>80%</td>
<td>75%</td>
<td>70%</td>
<td>74.14%</td>
</tr>
</tbody>
</table>

### Definition

Total outpatient revenue
Total patient revenue

### Interpretation

Measures the percentage of total revenues that are for outpatient revenues (including, for example, Rural Health Clinics, free-standing clinics, and home health clinics)
## Revenue: Patient Deductions

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractual allowances + Discounts</td>
<td>20%</td>
<td>22%</td>
<td>24%</td>
<td>38.92%</td>
</tr>
</tbody>
</table>

### Definition

Contractual allowances + Discounts

Gross total patient revenue

### Interpretation

Measures the allowances and discounts per dollar of total patient revenue
## Revenue: Medicare Inpatient Payer Mix

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare Inpatient Days</td>
<td>60%</td>
<td>65%</td>
<td>70%</td>
<td>73.59%</td>
</tr>
</tbody>
</table>

### Definition
Medicare inpatient days
Total inpatient days – Nursery bed days – NF Swing bed days

### Interpretation
Measures the percentage of total inpatient days that are provided to Medicare patients
## Revenue: Hospital Medicare Outpatient Payer Mix

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>20%</td>
<td>25%</td>
<td>30%</td>
<td>37.59%</td>
</tr>
</tbody>
</table>

### Definition
Hospital Outpatient Medicare charges
Hospital Total Outpatient Charges

### Interpretation
Measures the percentage of total outpatient charges that are for Medicare patients
### Revenue: Hospital Medicare Outpatient Cost to Charge

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.35</td>
<td>0.40</td>
<td>0.45</td>
<td>0.47</td>
</tr>
</tbody>
</table>

**Definition**
Hospital Medicare Outpatient Costs
Hospital Medicare Outpatient Charges

**Interpretation**
Measures outpatient Medicare costs per dollar of outpatient Medicare charges
## Revenue: Medicare Acute Inpatient Cost per Day

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$1,800</td>
<td>$1,700</td>
<td>$1,600</td>
<td>$2,193</td>
</tr>
</tbody>
</table>

**Definition**

Medicare acute inpatient cost (Medicare Inpatient Days (excl. HMO))

**Interpretation**

Measures the amount of Medicare revenue earned per Medicare day
## Cost: Salaries to Net Patient Revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>40%</td>
<td>42%</td>
<td>44%</td>
<td>44.87%</td>
</tr>
</tbody>
</table>

### Definition
- **Salary expense**
- Net patient revenue

### Interpretation
Measures the percentage of net patient revenue that are labor costs
## Cost: Average Age of Plant

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Age of Plant</td>
<td>8 years</td>
<td>9 years</td>
<td>10 years</td>
<td>9.83 years</td>
</tr>
</tbody>
</table>

### Definition

Accumulated depreciation

Depreciation expense * (365 / Days in Period)

### Interpretation

Measures the average accounting age in years of the fixed assets of an organization
## Cost: FTEs per Adjusted Occupied Bed

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Our Hospital</td>
<td>Median CAH</td>
<td>Median CAH</td>
<td>Median CAH</td>
</tr>
<tr>
<td>4.5 FTEs</td>
<td>5.0 FTEs</td>
<td>5.5 FTEs</td>
<td>5.79 FTEs</td>
</tr>
</tbody>
</table>

**Definition**

Number of FTEs
Adjusted occupied beds**

**Interpretation**

Measures the number of full-time employees per each occupied bed

** (Inpatient days – NF Swing days – Nursery days) *
(Total patient revenue / (Total inpatient revenue – Inpatient NF revenue – Other LTC Revenue)) / Days in period
## Cost: Average Salary per FTE

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Salary Expense</strong></td>
<td>$44,000</td>
<td>$46,000</td>
<td>$48,000</td>
<td>$49,316</td>
</tr>
<tr>
<td><strong>Number of FTEs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Definition**

Salary Expense
Number of FTEs

**Interpretation**

Measures the price and mix of labor.
## Utilization:
### Average Daily Census
#### Swing-SNF Beds

<table>
<thead>
<tr>
<th></th>
<th>2012 Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beds</td>
<td>4 beds</td>
<td>3 beds</td>
<td>2 beds</td>
<td>1.51 beds</td>
</tr>
</tbody>
</table>

**Definition**

Inpatient swing bed SNF days

Days in period

**Interpretation**

Measures the average number of swing-SNF beds occupied per day
## Utilization: Average Daily Census Acute Beds

<table>
<thead>
<tr>
<th>Year</th>
<th>Our Hospital</th>
<th>2012 Peer Group Median CAH</th>
<th>2012 State Median CAH</th>
<th>2012 U.S. Median CAH</th>
</tr>
</thead>
<tbody>
<tr>
<td>7 beds</td>
<td>6 beds</td>
<td>5 beds</td>
<td>3.38 beds</td>
<td></td>
</tr>
</tbody>
</table>

**Definition**

Inpatient acute care bed days

Days in period

**Interpretation**

Measures the average number of acute care beds occupied per day
Report Limitations

• Changing medians due to changing number of hospitals per year (although equilibrium is near)
• Timeliness of data (although recent numbers can be produced using the Calculator from our website)
• Explanations for differential performance are not identified
• CAH mission, service mix and operating environment are not considered
Examples of Data Quality Concerns

- Zero total revenues
- Negative net assets
- Negative current assets or current liabilities
- Negative days cash on hand
- Zero total expenses
- Negative net patient accounts receivable
- Zero inpatient days
- Zero outpatient charges
Conclusion

• Higher indicator values are not always good. Most indicators have a middle range of “good” values and extremes are “bad” values

• Each CAH has some indicators that look “good” and some that look “bad” relative to other CAHs, which may make overall financial position difficult to determine

• For this reason, significant judgment is required when analyzing financial and operating performance
Conclusion

• Investigate indicator values that are:
  – Far above or below peer group, state, and U.S. medians
  – Trending in the wrong direction
  – Highly erratic (data quality?)

• Understand the indicators as a group of measures
5. How hospitals can use the CAH Financial Indicators Report: An example
Their Hospital

- Let’s look at indicator values for *Their Hospital*
- What do you think about the financial performance and condition of *Their Hospital*?

- Profitability
- Liquidity
- Capital structure
## Profitability Indicators

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total margin</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Their Hospital</em></td>
<td>3.9%</td>
<td>-4.6%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>5.5%</td>
<td>5.6%</td>
<td>5.0%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>5.6%</td>
<td>5.7%</td>
<td>5.1%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>3.6%</td>
<td>3.6%</td>
<td>3.0%</td>
</tr>
<tr>
<td><strong>Cash flow margin</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Their Hospital</em></td>
<td>10.0%</td>
<td>2.7%</td>
<td>7.8%</td>
</tr>
<tr>
<td>Benchmark</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>9.2%</td>
<td>9.3%</td>
<td>8.7%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>10.3%</td>
<td>10.4%</td>
<td>9.8%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>6.0%</td>
<td>6.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td><strong>Return on equity</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Their Hospital</em></td>
<td>8.0%</td>
<td>-10.2%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>11.5%</td>
<td>11.6%</td>
<td>11.0%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>10.2%</td>
<td>10.3%</td>
<td>9.7%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>7.9%</td>
<td>8.0%</td>
<td>7.4%</td>
</tr>
<tr>
<td><strong>Operating margin</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Their Hospital</em></td>
<td>1.3%</td>
<td>0.9%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>2.0%</td>
<td>2.0%</td>
<td>1.4%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>1.4%</td>
<td>1.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>1.2%</td>
<td>0.8%</td>
<td>0.2%</td>
</tr>
</tbody>
</table>
Profitability – Indicator Findings

- Profitability declined and then increased. Could be an extraordinary one-time expense.
- Better than cash flow margin benchmark in most recent year
- Worse than peer group and state
- Negative total margin but positive cash flow margin can occur because cash flow margin includes depreciation and interest expense in numerator
- Conclusion: profitability is a concern.
Profitability – Potential Explanations

• Gross charges are relatively lower (less volume, lower rates, poorer payer mix, Medicaid?)
• Allowances are relatively higher (more competition?)
• Costs are relatively higher (wage rates, bad debt, charity care, inefficiency, or new debt?)
• Non-operating income is relatively lower (lower investments, less state or county support, lower charitable revenue?)
• Revenue, cost, and utilization indicators may provide additional insights
Profitability – Hospital Actions

- Increase revenues (better data capture, fewer referrals, fewer denials, new services, new markets, more physicians?)
- Control expenses (wage rates, staffing patterns, group purchasing, 340B, equipment management, information technology?)
- Improve negotiation policy with third party payers
- Increase investment returns
- Reduce charity care and bad debt
## Liquidity Indicators

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current ratio</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Their Hospital</td>
<td>2.9</td>
<td>2.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>2.2</td>
<td>2.3</td>
<td>2.3</td>
</tr>
<tr>
<td><strong>Days cash on hand</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Their Hospital</td>
<td>54</td>
<td>52</td>
<td>51</td>
</tr>
<tr>
<td>Benchmark</td>
<td>60</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>55</td>
<td>59</td>
<td>59</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>107</td>
<td>111</td>
<td>111</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>55</td>
<td>59</td>
<td>59</td>
</tr>
<tr>
<td><strong>Days revenue in accounts receivable</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Their Hospital</td>
<td>57</td>
<td>73</td>
<td>81</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>55</td>
<td>55</td>
<td>56</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>59</td>
<td>59</td>
<td>60</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>59</td>
<td>59</td>
<td>60</td>
</tr>
</tbody>
</table>
Liquidity – Indicator Findings

• Conflicting results.
• Current ratio declined over the past three years, but still better than industry. Days cash on hand declined but worse than industry.
• Days revenue in accounts receivable increasing and worse than industry. If credit policy has not changed, third party payers are taking longer to pay.
Liquidity – Potential Explanations

• Current ratio and days cash on hand
  – assets are relatively lower (greater draw on cash or smaller inventory?)
  – Current liabilities are relatively higher (longer payment periods or new debt?)
  – Operating costs are relatively higher (inefficiency or new debt?)

• Days revenue in accounts receivable
  – Change in payer mix, increasing length of stay, clerical staffing problems, a nursing strike, change in Medicaid policies, higher denial rate, etc.

• Revenue, cost, and utilization indicators may provide additional insights
Liquidity – Hospital Actions

- Identify reasons for the decline in cash and improve cash management strategies
- Improve payables management to maintain good relations with suppliers
- Implement changes to the revenue cycle for faster collection, lower collection expenses and fewer denials
## Capital Structure Analysis – Indicator Findings

<table>
<thead>
<tr>
<th>Equity financing</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Their Hospital</td>
<td>53%</td>
<td>65%</td>
<td>67%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>61%</td>
<td>61%</td>
<td>65%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>56%</td>
<td>56%</td>
<td>60%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>61%</td>
<td>61%</td>
<td>65%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debt service coverage</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Their Hospital</td>
<td>3.1</td>
<td>3.0</td>
<td>1.3</td>
</tr>
<tr>
<td>Benchmark</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>4.4</td>
<td>4.3</td>
<td>3.8</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>4.7</td>
<td>4.6</td>
<td>4.1</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>3.4</td>
<td>3.3</td>
<td>2.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long-term debt to capitalization</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Their Hospital</td>
<td>31%</td>
<td>25%</td>
<td>22%</td>
</tr>
<tr>
<td>Benchmark</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Peer Group Median CAH</td>
<td>27%</td>
<td>29%</td>
<td>25%</td>
</tr>
<tr>
<td>State Median CAH</td>
<td>33%</td>
<td>35%</td>
<td>31%</td>
</tr>
<tr>
<td>U.S. Median CAH</td>
<td>24%</td>
<td>26%</td>
<td>22%</td>
</tr>
</tbody>
</table>
Capital Structure – Indicator Findings

- Conflicting results.
- Equity financing increased over the past three years and better than industry.
- Long-term debt to capitalization declined and better than industry.
- Debt service coverage declined and worse than industry
Capital Structure – Potential Explanations

- Hospital may have retired debt in year 3
- Large principal repayments temporarily reduce debt service coverage
- Revenue, cost, and utilization indicators may provide additional insights
Capital Structure – Hospital Actions

- Assess ability to carry additional long-term debt and other types of capital
- Investigate sources of capital available to CAHs
Implications

- Higher indicator values are not always good. Most indicators have a middle range of “good” values and extremes are “bad” values.
- Each CAH has some indicators that look “good” and some that look “bad” relative to other CAHs, which may make overall financial position difficult to determine.
Rules of Thumb

• Compare relative financial performance of a CAH:
  – First to benchmark (for 5 indicators)
  – Second to peer group median
  – Third to state median
  – Fourth to U.S. median

• Assign greater weight to recent indicator values
Rules of Thumb

• Investigate indicator values that are:
  – Far above or below peer group, state, and U.S. medians
  – Trending in the wrong direction
  – Highly erratic (data quality?)

• Understand the indicators as a group of measures
Conclusion

- “Firms that have high profits, lots of cash, little debt, and new plants have great financial strength. Firms with losses, little cash, lots of debt, and old physical facilities will not be in business long.” (Cleverley and Cameron)
6. Benchmark Report
Benchmark Report: Purpose

- Benchmarks identify good financial performance and provide specific targets for improvement.
- The intent of the benchmarks is to provide a relevant and useful basis to assess the financial performance and condition of CAHs.
- Medians change over time but benchmarks provide a constant basis on which to judge financial performance and condition.
Benchmark Report: Development

• Established by survey of informed practitioners versus academic black box or arbitrary rankings
• Based on a large sample of practitioners
• Results showed strong support for benchmarks being “about right”
• Peer group, state and national performance against benchmarks also reported
Benchmark Report: Interpretation

• There is year-to-year variation in indicator values.
• Capital projects, medical staff changes, and other circumstances may affect your hospital’s value.
• Errors or other data quality problems may be present in the Medicare Cost Report submitted by your hospital.
• Few hospitals perform better than benchmark on all twelve indicators.
Benchmark Report: Sample Report

What was my hospital’s performance relative to the benchmarks?

**Your 2012 Performance Compared to Benchmarks**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Your Value</th>
<th>Benchmark</th>
<th>Met?</th>
<th>Percent of CAHs Meeting Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Margin (percent)</td>
<td>6.88</td>
<td>&gt;3</td>
<td>Yes</td>
<td>48% 50% 67%</td>
</tr>
<tr>
<td>Cash Flow Margin (percent)</td>
<td>10.13</td>
<td>&gt;5</td>
<td>Yes</td>
<td>60% 56% 67%</td>
</tr>
<tr>
<td>Operating Margin (percent)</td>
<td>6.62</td>
<td>&gt;2</td>
<td>Yes</td>
<td>45% 28% 67%</td>
</tr>
<tr>
<td>Return on Equity (percent)</td>
<td>9.78</td>
<td>&gt;4.5</td>
<td>Yes</td>
<td>54% 62% 62%</td>
</tr>
<tr>
<td>Current Ratio (times)</td>
<td>5.40</td>
<td>&gt;2.3</td>
<td>Yes</td>
<td>51% 58% 56%</td>
</tr>
<tr>
<td>Days Cash on Hand (days)</td>
<td>216.50</td>
<td>&gt;60</td>
<td>Yes</td>
<td>55% 58% 50%</td>
</tr>
<tr>
<td>Days Revenue in Accounts Receivable&lt;sup&gt;1&lt;/sup&gt; (days)</td>
<td>71.96</td>
<td>&lt;53</td>
<td>No</td>
<td>51% 38% 11%</td>
</tr>
<tr>
<td>Equity Financing (percent)</td>
<td>83.61</td>
<td>&gt;60</td>
<td>Yes</td>
<td>51% 62% 88%</td>
</tr>
<tr>
<td>Debt Service Coverage (times)</td>
<td>&lt;3</td>
<td>&lt;3</td>
<td>No</td>
<td>58% 41% 50%</td>
</tr>
<tr>
<td>LT Debt to Capitalization&lt;sup&gt;1&lt;/sup&gt; (percent)</td>
<td>0.00</td>
<td>&lt;25</td>
<td>Yes</td>
<td>58% 75% 88%</td>
</tr>
<tr>
<td>Medicare O/P Cost to Charge&lt;sup&gt;1&lt;/sup&gt; (times)</td>
<td>0.90</td>
<td>&lt;.55</td>
<td>No</td>
<td>60% 42% 22%</td>
</tr>
<tr>
<td>Average Age of Plant&lt;sup&gt;1&lt;/sup&gt; (years)</td>
<td>6.87</td>
<td>&lt;10</td>
<td>Yes</td>
<td>51% 35% 50%</td>
</tr>
</tbody>
</table>

Note: * denotes invalid value. See Technical Appendix for list of codes.

<sup>1</sup> For these ratios, lower values are associated with better financial performance.
## Benchmark Report: Profitability & Liquidity

<table>
<thead>
<tr>
<th>Metric</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total margin</td>
<td>Met all 4 benchmarks, but half of CAHs in peer group and 2/3 in the same state also met benchmarks.</td>
</tr>
<tr>
<td>Cash flow margin</td>
<td></td>
</tr>
<tr>
<td>Return on equity</td>
<td></td>
</tr>
<tr>
<td>Operating margin</td>
<td></td>
</tr>
<tr>
<td>Current ratio</td>
<td>Met 2 benchmarks but well short of days revenue in A/R benchmark. Most CAHs in peer group and same state also failed to meet benchmark. Perhaps a need for revenue cycle analysis.</td>
</tr>
<tr>
<td>Days cash on hand</td>
<td></td>
</tr>
<tr>
<td>Days revenue in A/R</td>
<td></td>
</tr>
<tr>
<td>Equity financing</td>
<td>Met 2 benchmarks but most CAHs in peer group and same state also met benchmarks. No value for debt service coverage because the CAH has no debt (LT debt to capitalization = 0).</td>
</tr>
<tr>
<td>------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Debt service coverage</td>
<td></td>
</tr>
<tr>
<td>LT debt to capitalization</td>
<td></td>
</tr>
<tr>
<td>Medicare O/P cost to charge</td>
<td>Well short of Medicare O/P cost to charge benchmark. Most CAHs in same state also failed to meet benchmark. Perhaps costs are too high, charges are too low, or both.</td>
</tr>
<tr>
<td>Average age of plant</td>
<td></td>
</tr>
</tbody>
</table>
7. Market Report
Market Report: Purpose

• Provides CAHs with basic market information necessary for:
  – assessment of market position,
  – identification of Medicare beneficiaries bypassing the hospital, and
  – strategic and operational planning.

• Through understanding their markets, CAHs can identify opportunities to allocate resources and to improve hospital financial and operational performance.
Market Report: Development

• Where did Medicare beneficiaries who reside in my market go for inpatient care?
  – The number of Medicare discharges for each residence ZIP code - hospital dyad was created from the Market Service Area files.
  – Dyads with a distance of more than 150 miles between the residence and the hospital were eliminated
  – Residence ZIPs were aggregated in descending order of number of discharges to the hospital until 75% of the hospital discharges was achieved.
Market Report: Development

• What are the socio-demographic characteristics of people who reside in my market compared to the average CAH market in my peer groups?
  – Data from Neilsen Site Reports is weighted by the population in each ZIP code to produce an array of sociodemographic measures of the population in the market area of the CAH.
Market Report: Interpretation

- There is year-to-year variation in Medicare admissions.
- Capital projects, medical staff changes, and other circumstances may affect Medicare admissions.
- Errors or other data quality problems may be present in the Market Service Area files.
- Market is defined by Medicare inpatient admissions only.
### 2012 Medicare Admissions

<table>
<thead>
<tr>
<th>Beneficiary Residence ZIP</th>
<th>Percent of Hospital Admissions</th>
<th>Share of ZIP</th>
<th>Market Leader</th>
<th>Leader Share of ZIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>00001</td>
<td>59.6</td>
<td>27.7</td>
<td>YOUR HOSPITAL</td>
<td>32.2</td>
</tr>
<tr>
<td>00002</td>
<td>28.5</td>
<td>15.8</td>
<td>OTHER HOSPITAL</td>
<td>32.7</td>
</tr>
<tr>
<td>00003</td>
<td>4.7</td>
<td>4.9</td>
<td>YOUR HOSPITAL</td>
<td>52.3</td>
</tr>
<tr>
<td>00004</td>
<td>2.5</td>
<td>2.2</td>
<td>OTHER HOSPITAL</td>
<td>58.8</td>
</tr>
<tr>
<td>00005</td>
<td>1.1</td>
<td>17.6</td>
<td>OTHER HOSPITAL</td>
<td>47.1</td>
</tr>
</tbody>
</table>

Five ZIPs with largest share listed, comprise 96.4 percent of the 277 Medicare admissions in 2012.

- Beneficiaries who live in ZIP 00001 are 59.6% of Your Hospital Medicare admissions.
- Your Hospital has 27.7% of all Medicare admissions from beneficiaries who live in ZIP 00001.
- Hospital with largest share of Medicare admissions from beneficiaries who live in ZIP 00001 has 32.2% of admissions.
## 2012 Market Characteristics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Your Hospital</th>
<th>Peer Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent Elderly</td>
<td>19.5</td>
<td>18.4</td>
</tr>
<tr>
<td>Percent Unemployed</td>
<td>9.1</td>
<td>8.4</td>
</tr>
<tr>
<td>Per Capita Income (dollars)</td>
<td>19,558</td>
<td>21,161</td>
</tr>
<tr>
<td>Percent in Poverty</td>
<td>14.8</td>
<td>10.7</td>
</tr>
<tr>
<td>Population in Market</td>
<td>24,888</td>
<td>25,989</td>
</tr>
<tr>
<td>Population per Square Mile</td>
<td>33.7</td>
<td>47.4</td>
</tr>
<tr>
<td>Average Distance to Hospital (miles)</td>
<td>14.5</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Compared to its peer group, *Your Hospital* has a market that has:
- A higher percent of elderly and unemployed
- Lower per capita income and higher percent in poverty
- Smaller total population, fewer population per square mile, and greater average distance to the hospital
8. Medicare Outpatient Report
Medicare Outpatient Report: Purpose

- CAHs are primarily outpatient facilities – on average, 70% of CAH revenue is for outpatients
- Medicare beneficiaries represent 36% of total outpatient revenue, on average
- The purpose of this report is to provide CAHs with management information about their Medicare outpatient business
Medicare Outpatient Report: Development

- All outpatient services, including those provided in an emergency department setting, provided to Medicare beneficiaries by a CAH are included.
- Outpatient claims are grouped by primary diagnosis using the Clinical Classifications Software (CCS) for ICD-9-CM.
- The top 20 primary diagnoses ranked by the number of claims are included in the report.
Medicare Outpatient Report: Interpretation

• Average charges and provider payment per claim provide hospitals with information about their pricing and contractual allowances / discounts for outpatient services.

• Average charges and provider payment per patient per year provide hospitals with information that may be helpful to CAHs considering participation in an accountable care organization (ACO) or bundled payment.
### Medicare Outpatient Report: Sample Report

#### Medicare Outpatient Claims (2012)
Ranked by Number of Claims

<table>
<thead>
<tr>
<th>Rank</th>
<th>Primary Diagnosis (AHRQ CCS)</th>
<th>Average Per Claim</th>
<th>Average Per Patient</th>
<th>Average claims per diagnosed patient per year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Charge</td>
<td>Provider payment</td>
<td>Charge</td>
</tr>
<tr>
<td>1</td>
<td>Other aftercare</td>
<td>$207</td>
<td>$184</td>
<td>$1137</td>
</tr>
<tr>
<td>2</td>
<td>Rehab care; prostheses; adj device</td>
<td>$1606</td>
<td>$1536</td>
<td>$4610</td>
</tr>
<tr>
<td>3</td>
<td>Chronic ulcer of skin</td>
<td>$495</td>
<td>$431</td>
<td>$2837</td>
</tr>
<tr>
<td>4</td>
<td>Spasticity; intervert disc disorder</td>
<td>$564</td>
<td>$520</td>
<td>$677</td>
</tr>
<tr>
<td>5</td>
<td>Other non-traumatic joint disorders</td>
<td>$1337</td>
<td>$1214</td>
<td>$1872</td>
</tr>
<tr>
<td>6</td>
<td>Other lower respiratory disease</td>
<td>$663</td>
<td>$580</td>
<td>$912</td>
</tr>
<tr>
<td>7</td>
<td>Genitourinary symp and ill-defined</td>
<td>$1367</td>
<td>$1212</td>
<td>$1671</td>
</tr>
<tr>
<td>8</td>
<td>Abdominal pain</td>
<td>$767</td>
<td>$666</td>
<td>$1023</td>
</tr>
<tr>
<td>9</td>
<td>Other connective tissue disease</td>
<td>$2274</td>
<td>$2122</td>
<td>$2791</td>
</tr>
<tr>
<td>10</td>
<td>Nonspecific chest pain</td>
<td>$414</td>
<td>$384</td>
<td>$490</td>
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<tr>
<td>11</td>
<td>Essential hypertension</td>
<td>$278</td>
<td>$265</td>
<td>$365</td>
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<td>12</td>
<td>Rheumatoid arth and related dis</td>
<td>$574</td>
<td>$512</td>
<td>$670</td>
</tr>
<tr>
<td>13</td>
<td>Diabetes mellitus w/o complication</td>
<td>$1416</td>
<td>$1272</td>
<td>$1490</td>
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<tr>
<td>14</td>
<td>Urinary tract infections</td>
<td>$679</td>
<td>$567</td>
<td>$1050</td>
</tr>
<tr>
<td>15</td>
<td>Schiz and other psychotic dis</td>
<td>$1513</td>
<td>$1345</td>
<td>$1838</td>
</tr>
<tr>
<td>16</td>
<td>Cardiac dysrhythmias</td>
<td>$294</td>
<td>$291</td>
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<tr>
<td>17</td>
<td>Other gastrointestinal disorders</td>
<td>$1469</td>
<td>$1284</td>
<td>$3327</td>
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<tr>
<td>18</td>
<td>Other upper respiratory infections</td>
<td>$1081</td>
<td>$975</td>
<td>$2500</td>
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<td>TOTAL</td>
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</table>
List of Peer Hospitals

• CAH administrators have indicated that it is useful to know the identity of peer hospitals so that direct comparisons with other similar facilities can be made.
• This could facilitate dialogue and performance improvement efforts among similar hospitals.
• Peer hospital name, town, and state are provided.
Other aftercare is most common diagnosis of Medicare outpatients

For this diagnosis, the average charge per claim was $207 and the average provider payment was $184

The average annual charges per patient was $1137 and the average annual provider payment was $1008

The average number of claims per diagnosed patient per year was 5.5
• For all Medicare outpatients at this hospital:
  – The average charge per claim was $1081 and the average provider payment was $975
  – The average annual charges per patient was $2500 and the average annual provider payment was $2254
  – The average number of claims per diagnosed patient per year was 2.3
• These can be compared to national averages