American Hospital
Association

AMERICAN HOSPITAL ASSOCIATION
UNCOMPENSATED HOSPITAL CARE COST
FACT SHEET

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Each year, the American Hospital Association (AHA) publishes aggregate information on the level of uncompensated care delivered in U.S. hospitals. The data used to generate these numbers comes from the AHA's Annual Survey of Hospitals, which is the nation's single most comprehensive source of hospital financial data. This fact sheet provides the definition of uncompensated care and technical information on how this figure is calculated on a cost basis. It also describes how the American Institute of Certified Public Accountants (AICPA) accounting changes to bad debt and free care are currently handled in the Survey to ensure continuity of uncompensated care numbers.

DEFINING UNCOMPENSATED CARE COSTS

What is Uncompensated Care?

Uncompensated care is an overall measure of hospital care provided for which no payment was received from the patient or insurer. It is the sum of a hospital's "bad debt" and the charity care it provides. Charity care is care for which hospitals never expected to be reimbursed. A hospital incurs bad debt when it cannot obtain reimbursement for care provided. This happens when patients are unable or unwilling to pay their bills. Uncompensated care excludes other voluntary or involuntary discounts or "reductions in revenue," such as underpayment from Medicaid and Medicare or discounts to private payers.

Bad Debt and Charity Care

For policy purposes, AHA combines the hospital's bad debt and charity care costs to arrive at the hospital's total burden of unreimbursed care provided to the medically indigent and underinsured. In terms of accounting, **bad debt** consists of services for which hospitals anticipated but did not receive payment. **Charity care**, in contrast, consists of services for which hospitals neither received, nor expected to receive, payment because they had determined the patient's inability to pay. In practice, however, hospitals have difficulty in distinguishing bad debt from charity care.

Hospitals provide varying levels of charity care, which must be budgeted for and financed by the hospital depending on the hospital's mission, financial condition, and other factors. Some hospitals use a formal process to identify who can and cannot afford to pay, in advance of billing, in order to anticipate whether the patient's care could be funded through an alternative source such as a charity care fund. On the other hand, some hospitals use the billing and collection process to identify those patients who are unable to pay. Care delivered to a patient may be classified as charity care by one hospital, but bad debt by another. This does not mean, however, that care classified as bad debt was provided to patients who can afford to pay. On the contrary, bad debt can be generated by people with limited resources, making the distinctions between the two categories virtually meaningless.

Added to the fact that bad debt and charity care are not strictly comparable across facilities due to institutional practices, several studies suggest that health care bad debt is more often than not accounted for by care provided to people who cannot afford to pay their hospital bills. It is, therefore, reasonable to consider bad debt as a component of hospitals total burden of care to the medically indigent and underinsured.

Generally, uncompensated care data are expressed in terms of hospital charges, but charge data can be misleading, particularly when comparisons are being made among types of hospitals, or hospitals with very different payer mixes. **For this reason, AHA data on hospitals' uncompensated care are expressed in terms of costs.** It should be noted that the uncompensated care figures do not include Medicaid or Medicare underpayment costs, or contractual allowances.

CALCULATING UNCOMPENSATED CARE COSTS

Uncompensated care is first calculated on a hospital by hospital basis. Bad debt and charity care are reported as charges in the Annual Survey. These two numbers are added together and then multiplied by the hospital's cost to charge ratio, or the ratio of total expenses to gross patient and other operating revenue.

- Bad Debt charges + charity care charges = uncompensated care charges

- Total expenses/(gross patient revenue + other operating revenue)
  = cost-to-charge ratio

- Uncompensated care charges x cost-to-charge ratio = uncompensated care costs

Combining bad debt and charity care to arrive at the hospital's total uncompensated care value allows for comparability across hospitals. While the 1990 (AICPA) accounting changes used to classify these costs (described below) result in some shifting between bad debt and charity care, they are not expected to influence the total reported cost of uncompensated care. The total reported national uncompensated care cost value is calculated by summing the individual uncompensated care cost values across all hospitals.

AICPA CHANGES AND THE ANNUAL SURVEY

In 1990, the American Institute of Certified Public Accounts made important changes to its Audit and Accounting Guide, which impact bad debt and charity care. The Guide is the industry standard for health care financial reporting and audits.

Prior to 1990, hospitals reported both bad debt and charity care as deductions from revenue. The new rules require different reporting of the two items. For purposes of external financial statements, charity care is no longer a reported item. Hospitals must now report only net revenue. It is presumed that hospitals will continue to internally account for charity care as a deduction from gross revenue. Bad debt, in contrast, must be reported as an expense item (it may be either separately reported or reported with administrative services or other adjustments) and is no longer deducted from gross revenue. The AHA uncompensated care data is processed to assure its comparability to data presented before the 1990 AICPA changes.

Please refer questions regarding this fact sheet to: Caroline Steinberg, AHA Policy Division (202-626-2329); Peter Kralovec, AHA Healthcare InfoSource (312-422-3523); or Molly Collins Offner, AHA Policy Division (202-626-2326). Please note this fact sheet is a discussion of uncompensated care costs; other measures such as unsponsored care are not included.

National Uncompensated Care Based on Cost*: 1980-2004 (in Billions), Registered Community Hospitals

Year	Hospitals	Uncompensated Care Cost	% of Total Expenses
1980	5828	$3.9	5.1%
1981	5812	$4.7	5.2%
1982	5796	$5.3	5.1%
1983	5782	$6.1	5.3%
1984	5757	$7.4	6.0%
1985	5729	$7.6	5.8%
1986	5676	$8.9	6.4%
1987	5597	$9.5	6.2%
1988	5499	$10.4	6.2%
1989	5448	$11.1	6.0%
1990	5370	$12.1	6.0%
1991	5329	$13.4	6.0%
1992	5287	$14.7	5.9%
1993	5252	$16.0	6.0%
1994	5206	$16.8	6.1%
1995	5166	$17.5	6.1%
1996	5134	$18.0	6.1%
1997	5057	$18.5	6.0%
1998	5015	$19.0	6.0%
1999	4956	$20.7	6.2%
2000	4915	$21.6	6.0%
2001	4908	$21.5	5.6%
2002	4927	$22.3	5.4%
2003	4895	$24.9	5.5%
2004	4919	$26.9	5.6%

Source: Health Forum, AHA Annual Survey Data, 1980-2004

*The above uncompensated care figures represent the estimated ***cost*** of bad debt and charity care to the hospital. This figure is calculated for each hospital by multiplying uncompensated care charge data by the ratio of total expenses to gross patient and other operating revenues. The total uncompensated care cost is arrived at by summing all individual hospital values.

The uncompensated care figure does not include Medicaid or Medicare underpayment costs, or other contractual allowances. Moreover, the figure does not take into account the small number of hospitals that derive the majority of their income from tax appropriations, grants and contributions.

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