AMERICAN HOSPITAL ASSOCIATION
UNDERPAYMENT BY MEDICARE AND MEDICAID
FACT SHEET

December 2010

Each year, the American Hospital Association (AHA) collects aggregate information on the payments and costs associated with care delivered to beneficiaries of Medicare and Medicaid by U.S. hospitals. The data used to generate these numbers come from the AHA's Annual Survey of Hospitals, which is the nation's most comprehensive source of hospital financial data. This fact sheet provides the definition of underpayment and technical information on how this figure is calculated on a cost basis for Medicare and Medicaid.

Payment rates for Medicare and Medicaid, with the exception of managed care plans, are set by law rather than through a negotiation process as with private insurers. These payment rates are currently set below the costs of providing care resulting in underpayment. Payments made by managed care plans contracting with the Medicare and Medicaid programs are generally negotiated with the hospital.

Hospital participation in Medicare and Medicaid is voluntary. However, as a condition for receiving federal tax exemption for providing health care to the community, not for profit hospitals are required to care for Medicare and Medicaid beneficiaries. Also, Medicare and Medicaid account for 56 percent of all care provided by hospitals. Consequently, very few hospitals can elect not to participate in Medicare and Medicaid.

Bridging the gaps created by government underpayments from Medicare and Medicaid is only one of the benefits that hospitals provide to their communities. In a separate fact sheet, AHA has calculated the cost of uncompensated hospital care (charity care and bad debt), which also are benefits to the community. While these two fact sheets contain important information, they do not account for the many other services and programs that hospitals provide to meet identified community needs.

DEFINING UNDERPAYMENT

Underpayment is the difference between the costs incurred and the reimbursement received for delivering care to patients. Underpayment occurs when the payment received is less than the *costs* of providing care, i.e., the amount *paid by* hospitals for the personnel, technology and other goods and services required to provide hospital care is less than the amount *paid to* them by Medicare or Medicaid for providing that care. Underpayment is not the same as a contractual allowance, which is the difference between hospital charges and government program payments.

CALCULATING UNDERPAYMENTS

Payments received by hospitals for Medicare and Medicaid services are reported for each hospital in the AHA Annual Survey.[1] Hospitals also report their gross charges for Medicare and Medicaid services provided. Gross charges for these services are then translated into costs. This is done by multiplying each hospital's gross charges by each hospital's overall cost-to-charge ratio, which is the ratio of a hospital's costs (total expenses exclusive of bad debt) to its charges (gross patient and other operating revenue).

- Payment = Amount Received
- Cost-to-charge Ratio = $\dfrac{\text{Total Expenses Exclusive of Bad Debt}}{\text{Gross Patient Revenue + Other Operating Revenue}}$
- Costs = Gross Charges x Cost-to-charge Ratio

The resulting payment and cost figures are aggregated across all hospitals for Medicare and Medicaid. Payments are then compared to costs. Underpayment occurs when aggregate payments are less than costs.

- Underpayment = Amount by Which Payment is Less than Costs

FINDINGS

In the aggregate, both Medicare and Medicaid payments fall below costs and the shortfall has been growing.

- Combined underpayments rose from *$3.8 billion* in 2000 to *$36 billion* in 2009.
- For Medicare, hospitals received payment of only *90 cents* for every dollar spent by hospitals caring for Medicare patients in 2009.
- For Medicaid, hospitals received payment of only *89 cents* for every dollar spent by hospitals caring for Medicaid patients in 2009.
- In 2009, 60 percent of hospitals received Medicare payments less than cost, while 70 percent of hospitals received Medicaid payments less than cost.

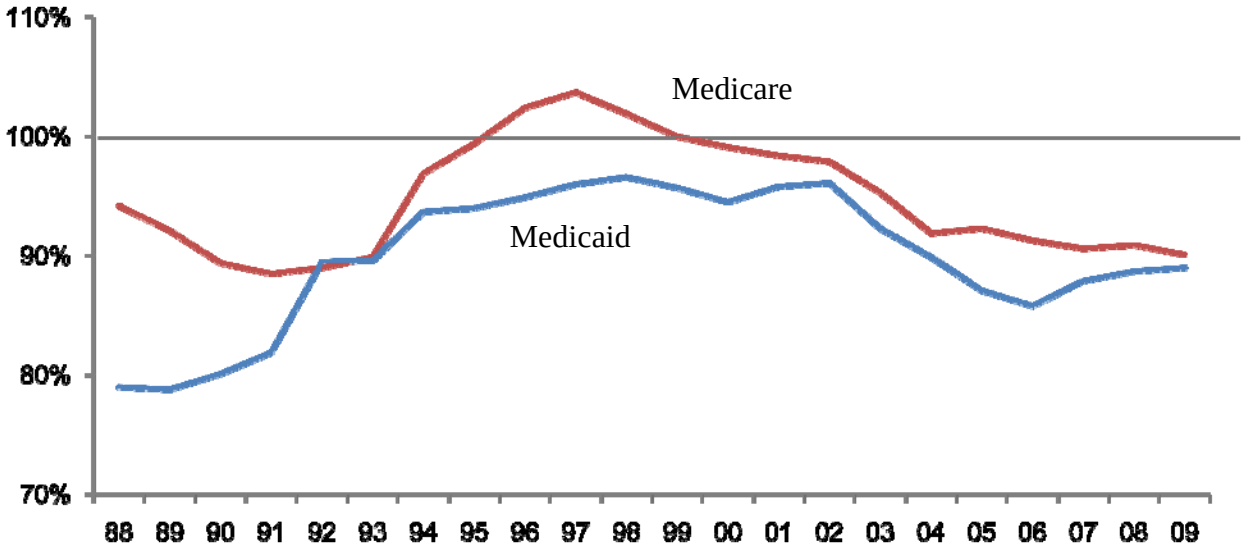
[1] Medicare and Medicaid payments include all applicable payment adjustments (Disproportionate Share, Indirect Medical Education, etc.). Payments include both fee-for-service and managed care payments.

National Government Underpayment for Medicare and Medicaid 2000-2009 (in Billions) Registered Community Hospitals

Year	Number of Hospitals	Underpayment in Billions Medicare	Medicaid	Total
2000	4915	$1.3	$2.5	$3.8
2001	4908	$2.3	$2.0	$4.3
2002	4927	$3.3	$2.3	$5.5
2003	4895	$8.1	$4.9	$13.0
2004	4919	$15.0	$7.1	$22.1
2005	4936	$15.5	$9.8	$25.3
2006	4927	$18.6	$11.3	$29.9
2007	4897	$21.5	$10.4	$31.9
2008	5010	$22.0	$10.4	$32.4
2009	5008	$25.2	$11.3	$36.5

Source: Health Forum, AHA Annual Survey Data, 2000-2009
Note: Medicare and Medicaid payments include all applicable payment adjustments (Disproportionate Share, Indirect Medical Education, etc.). Payments include both fee-for-service and managed care payments.

Aggregate Hospital Payment-to-Cost Ratios for Medicare and Medicaid 1988 – 2009



Source: Analysis of American Hospital Association Annual Survey data, 1988 - 2009, for community hospitals.
[1]Includes Medicaid Disproportionate Share payments.

Please refer questions regarding this fact sheet to: Caroline Steinberg, AHA Policy Division (202-626-2329).