



**American Hospital
Association**

**AMERICAN HOSPITAL ASSOCIATION
UNDERPAYMENT BY MEDICARE AND MEDICAID
FACT SHEET**

October 2006

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 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 underpayment and technical information on how this figure is calculated on a cost basis for Medicare and Medicaid.

Bridging the gaps created by 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 at little or no cost to their communities or for those benefits that cannot adequately be quantified.

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 payers. Payments made by managed care entities contracting with the Medicare and Medicaid programs are generally negotiated with the hospital.

Participation in Medicare and Medicaid is voluntary. However, as a condition for receiving federal tax exemption for providing health care to the community, hospitals are required to care for Medicare and Medicaid beneficiaries. Also, Medicare and Medicaid account for 55% of all care provided by hospitals. Consequently, very few hospitals elect not to participate in Medicare and Medicaid.

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 =
$$\frac{\text{total expenses exclusive of bad debt}}{\text{gross patient revenue} + \text{other operating revenue}}$$

■ 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 have been falling relative to costs resulting in combined underpayments rising from \$4.0 billion in 2000 to more than \$25 billion in 2005. This translates into payment of 92 cents and 87 cents for every dollar spent by hospitals caring for Medicare and Medicaid patients respectively. In 2005, 65% of hospitals received Medicare payments less than cost while 77% of hospitals received Medicaid payments less than cost.

Please refer questions regarding this fact sheet to: Caroline Steinberg, AHA Policy Division (202-626-2329) or Peter Kralovec, AHA Health Forum (312-422-3523).

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

**National Underpayment for Medicare and Medicaid¹: 2000-2005 (in Billions)
Registered Community Hospitals**

<u>Year</u>	<u>Number of Hospitals</u>	<u>Underpayment in Billions</u>	
		<u>Medicare</u>	<u>Medicaid</u>
2000	4915	\$1.4	\$2.6
2001	4908	\$2.4	\$2.1
2002	4927	\$3.4	\$2.3
2003	4895	\$8.1	\$5.0
2004	4919	\$15.0	\$7.1
2005	4936	\$15.5	\$9.8

Source: Health Forum, AHA Annual Survey Data, 2000-2005