



**American Hospital  
Association**

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

**December 2017**

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 more than 60 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 (financial assistance 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.<sup>1</sup> 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 fell below costs in 2016:

- Combined underpayments were \$68.8 billion in 2016. This includes a shortfall of \$48.8 billion for Medicare and \$20.0 billion for Medicaid.
- For Medicare, hospitals received payment of only 87 cents for every dollar spent by hospitals caring for Medicare patients in 2016.
- For Medicaid, hospitals received payment of only 88 cents for every dollar spent by hospitals caring for Medicaid patients in 2016.
- In 2016, 66 percent of hospitals received Medicare payments less than cost, while 61 percent of hospitals received Medicaid payments less than cost.

Please refer questions regarding this fact sheet to: Aaron Wesolowski, AHA Policy Division (202-626-2356).

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<sup>1</sup> 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.