

A Hospital Finance Basics Series

COST



INTRODUCTION

Providing hospital care is critical to the health and prosperity of Kansas communities. Hospitals depend on a highly educated and dedicated workforce in order to provide high quality care. Employee salaries, wages and benefits are the largest category of hospital costs.

HOSPITAL COST STRUCTURE

In 2021, Kansas hospitals spent about \$10.6 billion in total to fund hospital operations. (That is an average of about \$2,191 a day for each patient that is in a hospital). Employee salaries, wages and benefits along with supplies represented more than 69 percent of Kansas hospitals' total costs in 2021.

SALARIES WAGES AND BENEFITS

Labor expenses are the biggest component of hospital costs. Hospitals rely on their highly skilled personnel to deliver advanced levels of health care services. Kansas hospitals employed nearly 75,000 people and spent more than \$6 billion on salaries, wages and benefits in 2021.



**Kansas Hospital
ASSOCIATION**

FINANCE TERMINOLOGY

Cost - To providers: the expense incurred by a provider or hospital to deliver health care services to patients.

To payers: the amount insurers pay for services rendered.

To patients: the amount patients pay out-of-pocket for health care services.

Charge or Price – the amount listed by a provider for a health care good or service which appears on a medical bill.

Reimbursement – a payment made by a third party to a provider for services. This may be an amount for every service delivered (fee-for-service), for each day in the hospital (per diem), for each episode of hospitalization (e.g. diagnosis-related groups, or DRGs), or for each patient considered to be under their care (capitation).

SUPPLIES

Supplies are the second largest hospital cost category. This category includes medical supplies, drugs and other supplies such as food and linens. In 2021, Kansas hospitals spent about \$1.2 billion on medical supplies and \$1 billion on drugs. Overall, supplies accounted for 20 percent of Kansas hospitals' total costs in 2021.

FEES

Hospitals pay fees to a variety of outside entities and individuals for their services. These include physician on-call fees and stipends for medical directors. (Additional examples include legal fees and consulting fees).

CAPITAL: DEPRECIATION, AMORTIZATION AND INTEREST EXPENSE

Hospitals spread the cost of buildings, major medical equipment and other capitalized assets over their estimated life through accounting processes called depreciation and amortization. Additionally, hospitals often finance large purchases and must pay annual interest expenses on these loans. Kansas hospitals incurred about \$1 billion in depreciation, amortization and interest expenses in 2021.

PURCHASED SERVICES

Purchased services include expenses paid to outside agencies and individuals to complete specific projects or tasks. Examples of purchased services are repair, maintenance and shipping services.

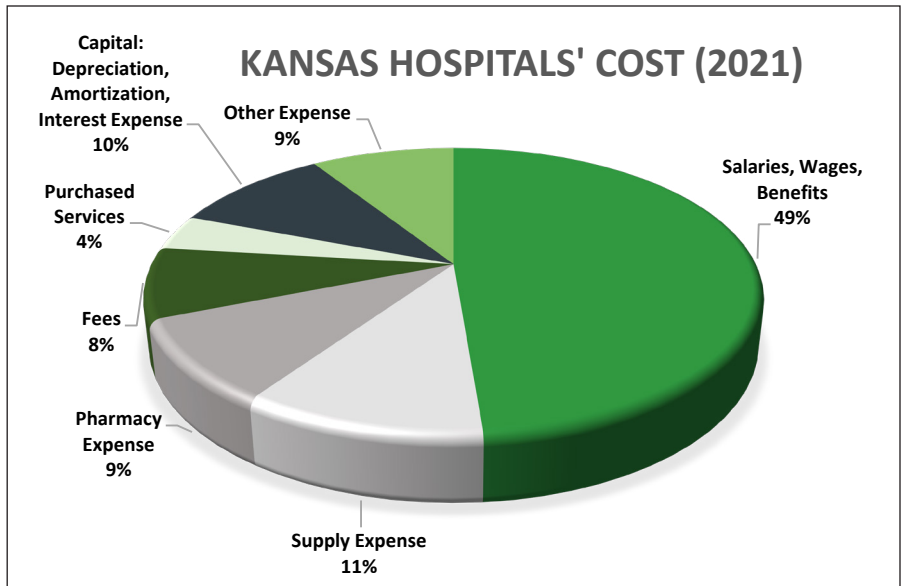
OTHER EXPENSES

Keeping a hospital running smoothly requires a number of routine expenses that are often classified as "other." These include items such as utilities, telephones, insurance, rents and leases.

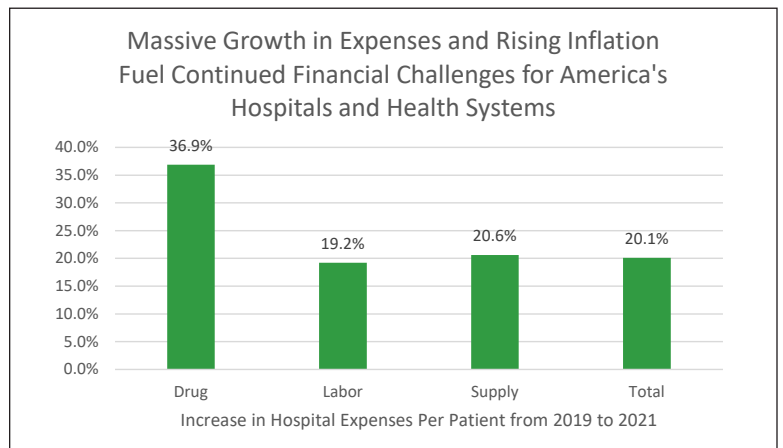
HOSPITAL OPERATING MARGIN

Hospital operating margin represents the difference between revenues collected and operating costs.

Providing hospital care, in many instances, produces a negative operating margin. According to a recent Kaufman Hall report, the average year-to-date



Kansas Hospital Association, American Hospital Association Annual Survey 2021



Source: "National Hospital Flash Report – November 2022", Kaufman Hall, www.kaufmanhall.com



**Data backs up the financial situation ...
 Providing hospital care is a slim margin business.
 According to a recent Kaufman Hall report, the
 average year-to-date operating margin for U.S.
 hospitals was -.5 percent through October 2022.**

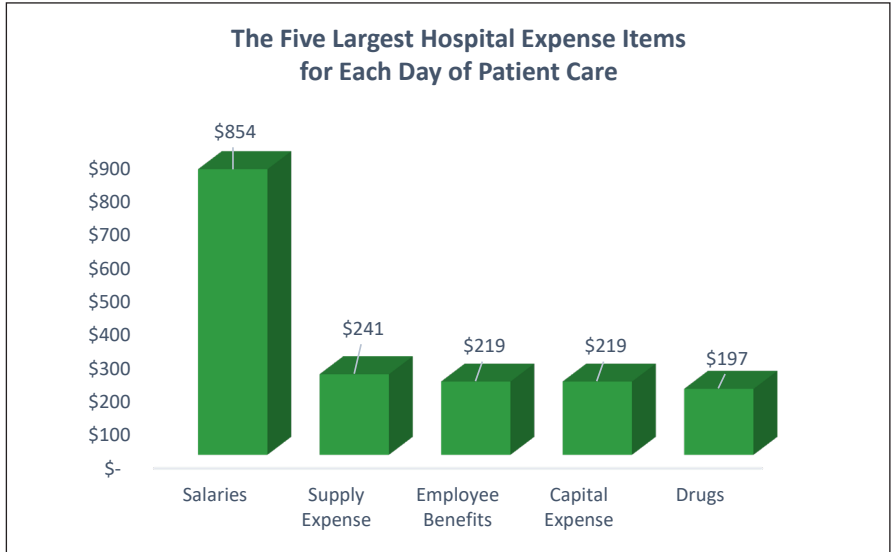
operating margin for U.S. hospitals was -.5 percent through October 2022. For a majority of the hospitals in Kansas, local tax subsidies are needed to keep hospital doors open. Of Kansas' 105 rural hospitals, 56 have been identified for risk of closure.

Hospital margins are slim compared to other health care sectors such as pharmaceuticals, medical supplies and health care information technology. As of January 2022, these industries had operating margins of 26.41 percent, 19.97 percent, and 21.41 percent, respectively. Another trend is the gap between hospital and insurance payer profits that continue to widen. The nation's largest insurers, UnitedHealth Group and Cigna, reported 2022 profits of \$20.6 billion and \$6.7 billion, respectively.

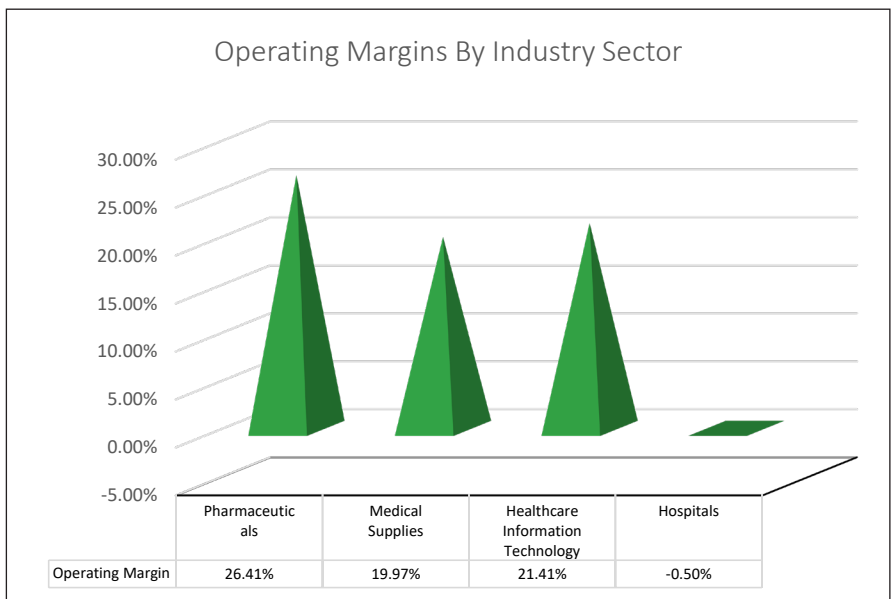
Money earned from providing health care services enables hospitals to invest in crucial resources. Hospitals earning inadequate margins may be forced to accumulate unsustainable levels of debt, delay hiring needed personnel or postpone investing in facility improvements. This can jeopardize community access to care.

KEY TAKEAWAY

Providing hospital care is a labor intensive and slim margin business. Hospitals rely on their highly skilled and dedicated workforce in order to provide advanced levels of health care services. Employee salaries,



Source: Hospital Adjusted Expenses per Inpatient Day, 2020, Kaiser Family Foundation



Source: "Margins by Sector" www.pages.stern.nyu.edu



wages and benefits make up about half of Kansas hospitals' total costs. Supplies accounted for another 20 percent of costs. As discussed in [Part One](#) of this series, continuous payment cuts can create an unsustainable business environment for hospitals. Much discussion at the federal, state and local level has focused on efforts to slow the growth of U.S. health care expenditures.

Kansas hospitals fully support responsible efforts to improve quality and reduce health care spending. In order to achieve meaningful savings, structural improvements must be made to the U.S. health care system to be more efficient and to avoid preventable hospitalizations.

SOURCES

- Kansas Cost Report Data, Kansas Hospital Association Financial Analysis
- Hospital Adjusted Expenses per Inpatient Day, 2020, Kaiser Family Foundation
- "National Hospital Flash Report – November 2022", Kaufman Hall, www.kaufmanhall.com
- "Margins by Sector" www.pages.stern.nyu.edu
- "Big payers ranked by 2022 profit", Beckers, 2022
- Kansas Hospital Association, American Hospital Association Annual Survey, 2021
- Center for Healthcare Quality and Payment Reform, 2023

This Hospital Finance Basics Series examines hospital costs - the resources necessary to provide high quality health care services. It is the second in a series about hospital finance.

Download Part One [here](#). Please reach out to Shannan Flach, Vice President Finance for additional information: sflach@kha-net.org or call (785) 233-7436.