www.hfma.org/ei

executive insights

...management strategies that drive results

June 2006

Focus on Finance

Hospital Prices: Who Is the Real Victim?

William O. Cleverley and James O. Cleverley

Pricing Transparency

The dialogue surrounding hospital pricing transparency has done little to bring clarity to the issue for consumers. In fact, the increased attention has led to added ambiguity at a time when greater understanding of this complex issue is required.

The country seems headed for hospital pricing disclosure, judging by the following evidence: In March, the U.S. Department of Health and Human Services announced plans to post the prices it pays for common medical procedures; the effort has been linked to a White House initiative for increased publication of healthcare pricing and quality data. Representatives Daniel Lipinski, D-Ill., and Bob Inglis, R-S.C., introduced legislation last July under the heading of the Hospital Price Reporting and Disclosure Act. The bipartisan effort is currently being considered and, if enacted, would require hospitals to report pricing for their 25 most commonly performed inpatient and outpatient procedures, along with their 50 most frequently administered medications. Several states have already passed similar legislation, and several more are in the process.

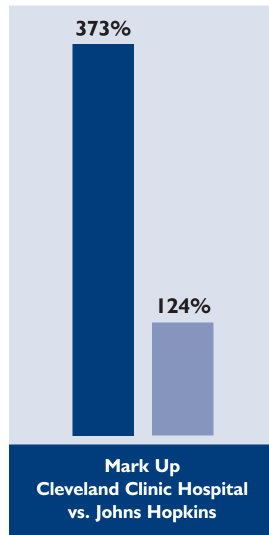
Cleveland Clinic Hospital (Cleveland, OH) charges 373% times its costs. That is 301% times what Johns Hopkins charges!

On average, Cleveland Clinic Hospital charges 3.0 times what Johns Hopkins charges, ranked the finest hospital in America.

Look at the price comparisons of Johns Hopkins versus Cleveland Clinic Hospital.

Compare Overall
Compare Ancillary Services

JOHNS HOPKINS HOSPITAL: The reason for comparing to Johns Hopkins Hospital? It is one of the finest hospitals in America. If they don't overcharge, why should your hospital overcharge?



Cleveland Clinic Hospital list prices are outrageous. On average Cleveland Clinic Hospital grants a 62% discount to people with insurance.

How much of a discount did they give you?

If Johns Hopkins is the best hospital in America, why is this hospital so much more expensive?

Certainly, the move toward pricing transparency is gaining momentum. While legislative efforts at the state and national levels have added fuel to the fire, private groups have become involved as well.

A significant amount of the increased public attention to pricing is related to the web site from which the screen shown is taken (www.hospitalvictims.com). A number of our clients have contacted us regarding this site, questioning the validity of the data presented. Upon review, we discovered a number of interesting points:

- The web site is maintained by Fairness Foundation, Inc., a not-for-profit tax-exempt 501(c)(3) organization founded in 1998.
- The Fairness Foundation, Inc., was founded by J. Patrick Rooney, who acquired Medical Savings Insurance Company. MSIC sells health policies with large deductibles largely to individuals and small groups. MSIC typically does not contract with hospitals.
- The web site states that patients may not have to pay charges.
- Regarding the reasonableness of a hospital's charges, the site's authors explain, "If you wish to dispute to the hospital the amount the hospital has charged you, it is important for you to know (a) what the hospital's costs are in relation to what the hospital normally charges; and (b) what Medicare would pay." The site's authors believe that the Medicare payment rate is a good beginning point for discussion with the hospital regarding payment. This, of course, is similar to MSIC's own payment rules.
- The data points provided on the site include:
  –Relationship of charges to cost
  –Relationship of charges

- for the hospital to charges at Johns Hopkins Hospital
- –Average discount given people with insurance
- –Additional ancillary service-charge comparisons

Validity

We believe the primary data used on the web site are from filed Medicare Cost Reports. We chose the page printed for Cleveland Clinic on April 12, 2006, because, like Johns Hopkins, the Cleveland Clinic is routinely ranked one of the top five U.S. hospitals; they both have wage indexes close to 1.00, they are similar in size, and both are major teaching hospitals. With this backdrop, let us review the numbers reported and the logic behind them.

Web site claim: The Cleveland Clinic charges 373 percent times its costs.

Reality: The Cleveland Clinic's 2004 Medicare Cost Report shows total gross patient revenue of $3,425,289,832 and total expenses of $918,725,605 from Worksheet G. This yields a markup of 3.73, or 373 percent.

Web site claim: Charges at Cleveland Clinic are 301 percent what Johns Hopkins charges.

Reality: This statistic is very misleading and simply not true. The 301 percent is derived (we believe) by multiplying the Cleveland Clinic's costs ($918,725,605) by the average markup at Johns Hopkins (1.24) to yield what total charges would have been at the Cleveland Clinic if Johns Hopkins' markup were used ($1,139,219,750). While this computation may yield a 301 percent multiple, it is a long way from proving that actual charges for identical case-treatment categories are 301 percent higher at the Cleveland Clinic.

The data show that charges at the Cleveland Clinic are not 301 percent of charges at Johns Hopkins; on average, they are 152 percent. It is also interesting to compare costs. Johns Hopkins is not a low-cost provider; it is 53 percent above the Cleveland Clinic. How, then, can charges at Johns Hopkins be so low when costs are so high?

The answer relates to Medicare payment in Maryland. Medicare pays 94 percent of charges in this rate-regulated state, as does Medicaid. Furthermore, other payers in Maryland pay either 98 percent or 100 percent of charges. Is it any wonder charges are so low in Maryland in general and at Johns Hopkins in particular? Johns Hopkins is clearly receiving significantly larger payments for its Medicare and Medicaid patients than are other U.S. hospitals. In short, Johns Hopkins is receiving a subsidy from the U.S. taxpayer that other hospitals do not receive.

Web site claim: On average, Cleveland Clinic grants a 62 percent discount to people with insurance.

Reality: The 62 percent figure is the ratio of deductions to gross patient revenue reported in Worksheet G of the Medicare Cost Report. It includes discounts to both Medicaid and Medicare patients, which are clearly not commercial insurance programs. While discounts to commercial insurance patients are high, they are usually substantially less than Medicaid and Medicare allowances. The inference is that individuals or insurance firms without contracts should get hospital discounts that will be better than those received by most commercial insurance firms, who have negotiated a hospital contract.

The Real Problem

There is no question regarding the relative relationship of hospital charges to cost. Everyone recognizes that hospitals have very high markups. The problem, however, is not hospital prices but rather payment rates by major third-party payers. The table at left provides a simple example to illustrate an issue that is painfully obvious to most hospital executives.

Comparison of Costs, Charges, and Medicare Payment for the Cleveland Clinic and Johns Hopkins (2004)

	Johns Hopkins	Cleveland Clinic	All U.S.
Average charge (CMI adj)	$12,292	$18,717	$15,241
Average cost (CMI adj)	9,601	6,279	6,267
Average payment (CMI adj)	11,358	6,402	5,667
DRG 127 charge (CMI adj)	$12,384	$20,180	$15,357
DRG 127 cost (CMI adj)	9,568	7,149	6,701
DRG 127 payment (CMI adj)	10,726	6,511	5,502

The table shows costs, charges, and payment for Medicare patients in 2004 for the Cleveland Clinic and Johns Hopkins. One set of values is for all Medicare inpatient cases on a case-mix-adjusted basis, and the other set is for the highest volume Medicare diagnosis-related group (DRG 127: heart failure and shock).

Markup for Sample Hospital

Revenue	
Medicare (50 patients at $92.50)	$4,625
Medicaid (13 patients at $75.00)	975
Uninsured (5 patients at $5.00)	25
Total revenue before commercial	$5,625
Cost and required profit	$10,400
Amount required from 32 commercial patients	$4,775
Amount required per case	$149.22

In this example, the hospital has 100 patients who each incur costs of $100 per treatment episode (total costs of $10,000). The hospital requires a 4 percent margin ($400). The table shows that if all commercial patients paid 100 percent of charges, the markup would be 149.22 percent.

The payment rate for Medicare ($92.50) is the Medicare Payment Advisory Commission estimated Medicare amount in 2004 for nonteaching hospitals (Table 2A-6, *March 2006 Report to the Congress: Medicare Payment Policy*). The distribution of patients is similar to the revenue composition of U.S. acute care hospitals in 2004.

The table shows that if all commercial patients paid 100 percent of charges, the markup would be 149.22 percent. The reality for most hospitals is that a small percentage of patients actually pay at that rate. Assume that of the 32 commercial patients, 28 pay at levels that are approximately 125 percent of cost, given existing negotiated contracts (total payment of $3,500). MedPAC reported the private payer payment-to-cost ratio was approximately 1.25 in 2003. This now leaves $1,275 to be paid by the remaining four patients, or $318.75 per case.

Charges or prices in our example are 318.75 percent of cost, but the hospital has a modest 4 percent margin. Some would argue this proves that hospital prices are not related to cost, but this is clearly not true. Hospital prices are directly tied to costs. The problem is that payment rates by major governmental programs and the rising incidence of uninsured patients create a very large payment gap that is covered by a majority of patients.

Perhaps the Fairness Foundation should consider changing the name of its web site from hospitalvictims.com to payervictims.com. The underlying issue is not hospital pricing but hospital payment. The use of Johns Hopkins Hospital as the standard for other hospitals points this out very clearly. When every payer pays between 94 percent and 100 percent of billed charges, as they do in Maryland, the relationship of price to cost will resemble markups in other industries. ■

William O. Cleverley, PhD, is president, Cleverley & Associates, Worthington, Ohio (info@cleverleyassociates.com). James O. Cleverley is a consultant with the firm.

Reprinted from the June 2006 issue of **executive insights.**
Copyright 2006 by Healthcare Financial Management Association, Two Westbrook Corporate Center, Suite 700, Westchester, IL 60154
For reprint information, call 1-800-252-HFMA