



**VCU**

School of Medicine  
Health Behavior and Policy

# Hospital Uncompensated Care Costs During the First Year of Medicaid Expansion in Virginia

November 2021

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### **Authorship and Acknowledgements**

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## Executive Summary

In May 2018, the Virginia General Assembly passed legislation that expanded Medicaid coverage to Virginia residents with incomes at or below 138% of the federal poverty line beginning January 1, 2019. Medicaid expansion increased access to care and improved health outcomes among the 500,000 new members who were enrolled as of January 1, 2021. The policy expanding eligibility drew broad support as an opportunity to substantially reduce hospital uncompensated care costs, which includes the cost of providing medical care to uninsured persons who are unable to pay for services.

The Department of Medical Assistance Services contracted with the Virginia Commonwealth University School of Medicine to conduct an evaluation of Medicaid expansion. Using data from Virginia Health Information's Hospital Detail Reports, this report examines the change in hospital uncompensated care costs in 2019 -- the first year of Medicaid expansion -- compared to costs in prior years. The report also shows how the change in uncompensated care costs differed by hospital characteristics, location and financial status.

Highlights from the report include:

- Total uncompensated care costs decreased by \$350 million between 2018 and 2019, reflecting a reduction of 27% based on 2019 dollars.
- Virginia's acute care hospitals provided a total of about \$950 million in uncompensated care in 2019, amounting to 4.5% of total operating costs.
- Hospital uncompensated care costs as a percent of total hospital operating costs decreased from 6.3% in 2018 to 4.5% in 2019.
- Although the level of uncompensated care varies by hospital ownership, location and type, uncompensated care costs decreased across the board for all major hospital groups.
- Consistent with the decrease in hospital uncompensated care, operating margins increased from 7.9% in 2017 to 9.7% in 2019, while total margins increased from 9.6% to 10.6% during the same time period. In addition, fewer hospitals had negative total margins in 2019 compared to 2017 and 2018.
- Critical Access Hospitals, generally located in rural areas of the state, historically have had higher uncompensated care costs relative to other acute care hospitals. For the seven Critical Access Hospitals in Virginia, uncompensated care costs as a percent of total costs decreased from 8.1% in 2017 to 5.5% in 2019, while uncompensated care costs declined from 5.9% to 4.2% for other acute care hospitals during the same time period.
- In part due to high uncompensated care costs, many rural Critical Access Hospitals struggle financially, often with negative operating and total margins. However, these hospitals experienced some of the most significant progress in financial performance, with operating margins improving from -8.1% in 2017 to -2.8% in 2019. This improvement began before Medicaid expansion, although four out of seven Critical Access Hospitals still had negative total margins in 2019.

## Introduction

On January 1, 2019, Virginia became the 33rd state to expand Medicaid coverage to residents with family incomes less than or equal to 138% of the federal poverty line. Medicaid expansion increased access to care and improved health outcomes among the 500,000 new members who were enrolled as of January 1, 2021. The policy expanding eligibility drew broad support as an opportunity to substantially reduce the costs to hospitals and other health care providers for treating uninsured persons. The state budget enacting Medicaid expansion included the establishment of assessments on hospitals to fund Virginia's share of the cost for the new members and to increase Medicaid payment rates to hospitals.

Much of the costs of providing hospital care to uninsured persons is "uncompensated" and absorbed by hospitals as part of their operating expenses. The federal 1986 Emergency Medical Treatment and Labor Act (EMTALA) requires all Medicare-participating hospitals with emergency departments to provide, at a minimum, stabilizing care to patients in need, regardless of their ability to pay. In addition, not-for-profit hospitals must provide "community benefits" (including charity care) in exchange for tax exemptions and as a condition for their Certificate Of Public Need (COPN) approval. To cover the uncompensated costs of providing care to uninsured patients, two acute care hospitals in Virginia that serve a disproportionately large number of uninsured people (VCU Health System and University of Virginia) receive federal Medicare and Medicaid Disproportionate Share Hospital (DSH) payments.

National studies have shown that the increase in patient revenue from Medicaid associated with Medicaid expansion resulted in an average 34% reduction in hospital uncompensated care costs following expanded eligibility.<sup>1,2</sup> As a result, overall hospital financial performance improved following Medicaid expansion, especially benefitting those hospitals that tend to serve a higher number of uninsured people. The rationale for the new provider assessments on Virginia hospitals is based in part on the expectation of reduced uncompensated care costs to hospitals, as well as increased revenue from a greater number of Medicaid patients and higher payment rates for these patients.

Based on these national studies, a previous VCU report estimated that Medicaid expansion would decrease hospital uncompensated care costs for Virginia hospitals by 26% to 43%, for a savings of between \$290 million and \$480 million.<sup>3</sup> However, the latest available data at the time of that study was from 2017, two years before Virginia expanded Medicaid.

The Department of Medical Assistance Services contracted with the Virginia Commonwealth University School of Medicine to conduct an evaluation of Medicaid expansion. The evaluation is conducted by faculty and staff from the Department of Health Behavior and Policy, and the Department of Family Medicine and Population Health. The evaluation includes an assessment of the impact of Medicaid expansion on hospital uncompensated care costs.

Using the most recent data available from 2019, this report describes the actual change in Virginia hospital uncompensated care costs in 2019 -- the first year of Medicaid expansion -- compared to prior years. The report describes trends in overall hospital uncompensated care costs, as well as differences by type of hospital and location in urban or rural areas. As the prior study showed that the level of uncompensated care is associated with hospital financial performance, the study also examines changes in hospital financial performance, including changes in both operating and total margins.

## Methodology

Cost estimates in this report are derived using the 2012-2019 Virginia Health Information (VHI) Hospital Detail Reports.<sup>4</sup> VHI financial data on hospitals are independently audited as part of hospitals' contractual obligation with the Virginia Department of Health to submit financial data. Data for 2019 was the most recent year available at the time of the analysis for this report.

Consistent with the definition used by the American Hospital Association, uncompensated care is defined as the sum of charity care costs and bad debt.<sup>5</sup> Charity care includes free or discounted services to low-income patients provided with no expectation of payment. Bad debt includes unpaid costs that the hospital expected but did not receive. Bad debt includes costs incurred by both uninsured patients as well as the costs of uncovered services or unpaid copayments for insured patients.

Data from VHI reflect hospital "charges," which overstate the true "costs" of care because hospitals rarely receive the full amount of charges due to contractual allowances from both public and private payers. Charges for charity care and bad debt are converted to costs using a hospital specific cost-to-charge ratio, consistent with the methodology used by the American Hospital Association.<sup>6</sup>

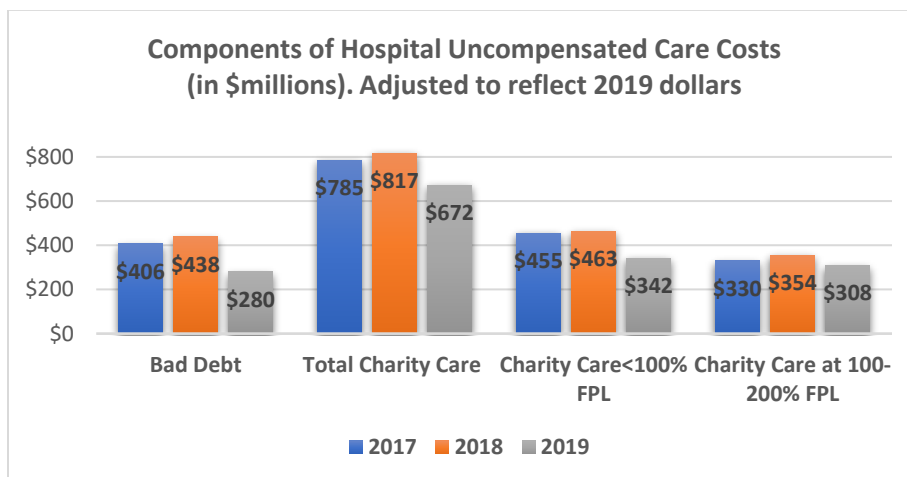
We estimate uncompensated care costs for the 80 short-term acute care hospitals in Virginia in 2019. We excluded long-term acute care hospitals, inpatient psychiatric hospitals, rehabilitation facilities and children's hospitals from the analysis. This analysis includes all acute hospitals, regardless of whether they pay a provider assessment, since these acute hospitals are likely to have benefited from new revenue associated with new coverage through Medicaid.

Definitions for all measures of hospital uncompensated care and financial performance are available in an Appendix to this document.

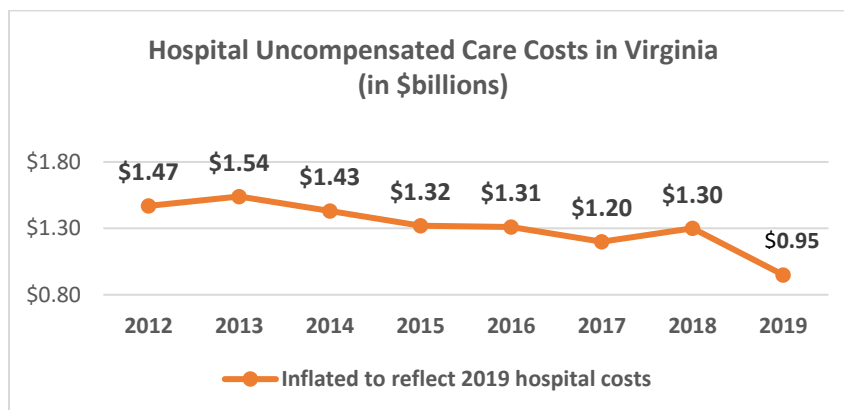
## Uncompensated Care Costs In Virginia in 2019

**In 2019, the first year of Medicaid expansion, hospital uncompensated care costs in Virginia amounted to \$950 million**, representing 4.5% of total hospital operating costs (that is, costs related to patient care). This is 1.8 percentage points lower than uncompensated care costs in 2018 (6.3%) and 1.4 percentage points lower than in 2017 (5.9 percentage points).

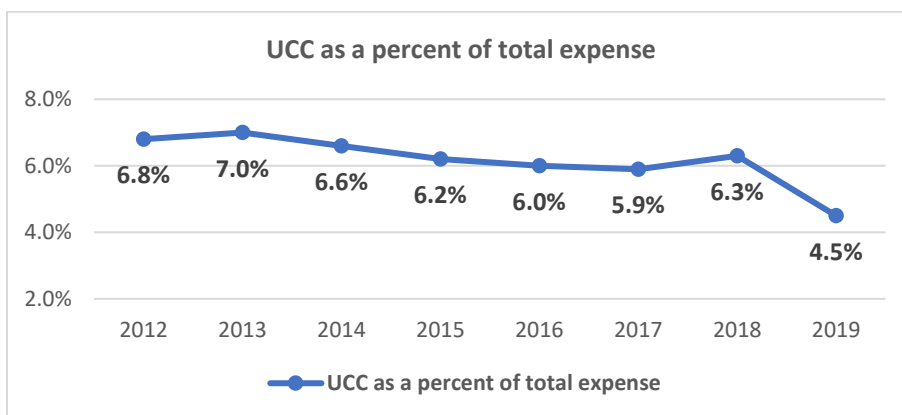
**Charity care comprised two-thirds of hospital uncompensated care costs in 2019 (\$672 million), while bad debt costs totaled \$280 million.** Most charity care costs were incurred for patients with incomes less than 200% of the federal poverty line (FPL) (\$650 million), which includes \$342 million incurred for patients under 100% FPL and \$308 million incurred for patients between 100% and 200% FPL. Charity care costs for patients with incomes less than 200% FPL in 2019 decreased by 20% from 2018 and 17% from 2017 (adjusted for 2019 dollars). Hospital bad debt in 2019 decreased by 31% from 2017 and by 36% from 2018 (adjusted for 2019 dollars).



Hospital uncompensated care costs have generally decreased since 2013 when adjusting for hospital price inflation using constant 2019 dollars. In the first year of Medicaid expansion, **uncompensated care costs decreased by 27%, from \$1.3 billion in 2018 to \$950 million in 2019**. Since 2013, uncompensated care costs have decreased by 38% based on constant 2019 dollars.



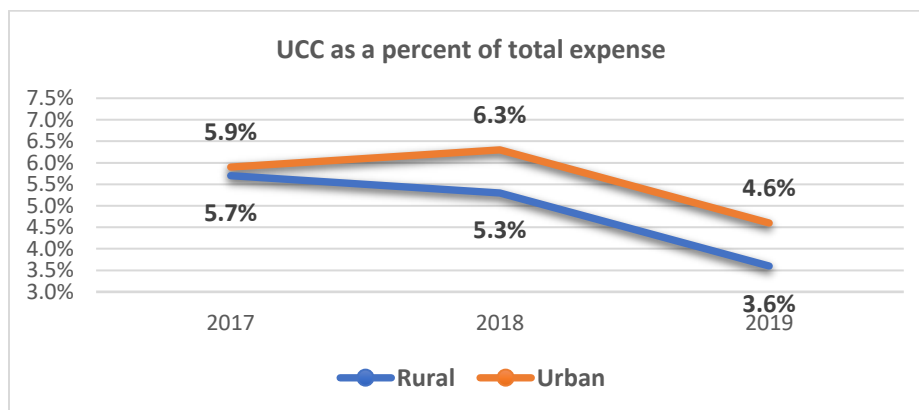
Hospital uncompensated care costs also decreased as a percent of total operating costs, from 6.3% in 2018 to 4.5% in 2019.



These reductions are consistent with prior national studies examining the change in hospital uncompensated care associated with Medicaid expansion in other states. Nationally, hospital uncompensated care costs decreased by 34% on average after Medicaid expansion.<sup>1</sup> Extrapolating from these national studies and using 2017 data for Virginia, a previous report estimated that Virginia hospital uncompensated care costs would decrease by 26% to 43% following Medicaid expansion, for a savings of between \$290 million and \$480 million.<sup>3</sup> **The actual decrease in hospital uncompensated care costs in the first year of Medicaid expansion is consistent with these previous estimates, showing a decrease of 27% between 2018 and 2019, amounting to a savings of \$350 million.**

### Urban and rural hospitals

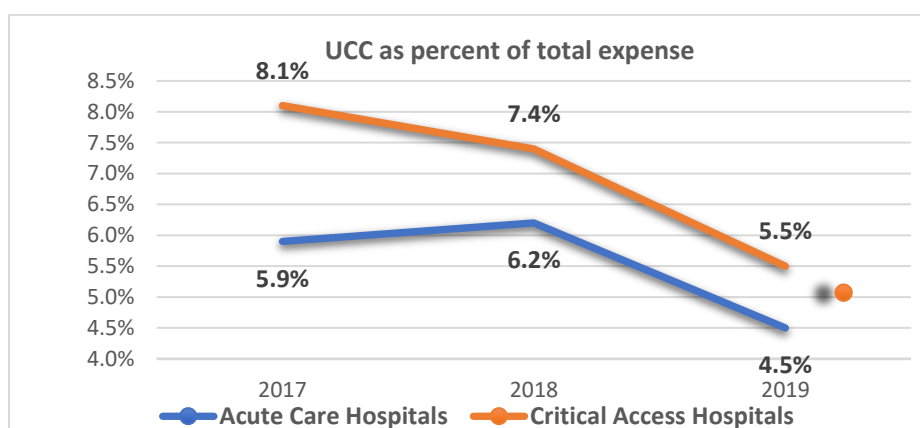
In 2017, 50 urban and 26 rural hospitals provided similar levels of uncompensated care relative to operating expenses (5.9% for urban hospitals and 5.7% for rural hospitals). Since 2017, uncompensated care at rural hospitals has decreased to a greater extent than at urban hospitals, including in the first year of Medicaid expansion. By 2019, uncompensated care at rural hospitals had decreased to 3.6% of operating expenses (a 37% decrease from 2017), compared to 4.6% at urban hospitals (a 22% decrease from 2017). This suggests that rural hospitals financially benefited from Medicaid expansion to a greater extent than urban hospitals.



### Critical Access Hospitals

There are seven Critical Access Hospitals in Virginia, all but one of which are located in rural areas. These are hospitals with 25 beds or fewer located at least 35 miles from another hospital, so they are often in geographically isolated areas of the state. Created through the federal Balanced Budget Act of 1997 as a result of a series of rural hospital closures, hospitals designated as Critical Access Hospitals receive higher Medicare payments to improve their financial viability and reduce the risk of closure.

Uncompensated care costs decreased for Critical Access Hospitals to a greater extent than other acute care hospitals, thereby narrowing the gap in the amount of uncompensated care that they provide. **Uncompensated care costs as a percent of total operating expenses decreased from 8.1% in 2017 to 5.5% in 2019, a 32% decrease.** Uncompensated care at other acute care hospitals decreased from 5.9% in 2017 to 4.5% in 2019, a 24 percent decrease.



### For profit and not-for profit hospitals

Most of Virginia's acute-care hospitals are not-for-profit. To maintain their tax exempt status, not-for-profit hospitals must demonstrate that they provide "community benefit," which includes charity care as well as other community health-related services. Virginia law also requires not-for-profit hospitals to provide community benefit as a condition for Certificate Of Public Need (COPN) approvals. For-profit hospitals have no such requirement.

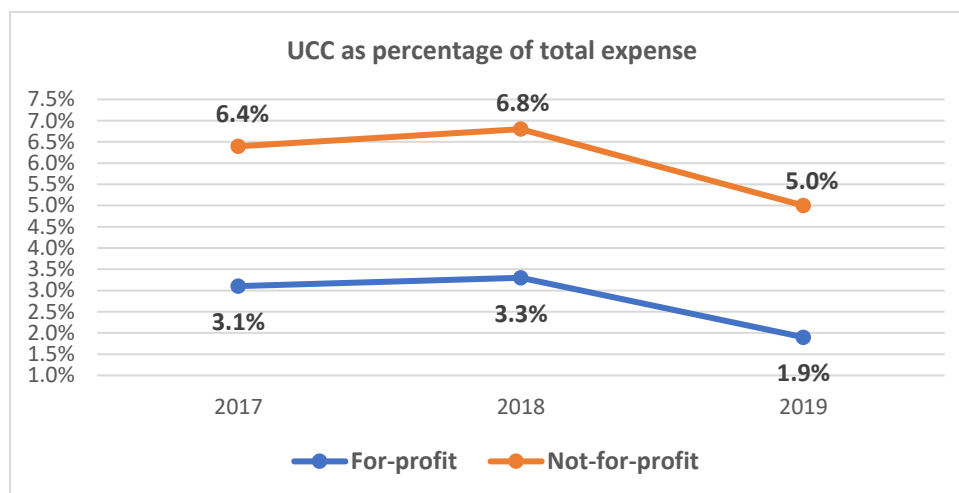
Levels of hospital uncompensated care are considerably higher in not-for-profit than for-profit hospitals:

- Sixty-one not-for-profit hospitals provided a total of \$1.03 billion in uncompensated care in 2017, representing 6.4% of their total operating costs. **Uncompensated care costs decreased to \$894 million in 2019 for not-for-profit hospitals**, or 5% of their operating costs, which represents a 1.4 percentage point decrease from 2017.
- For the state's two largest academic medical centers -- Virginia Commonwealth University (VCU) and University of Virginia (UVA) health systems -- uncompensated care costs decreased by only 0.6 percentage points, from 6.9% in 2017 to 6.3% in 2019 (findings not shown). This suggests that these two health systems experienced less of an impact from Medicaid expansion on their uncompensated care compared to other not-for-profit hospitals. The reasons for this are unclear. It is possible that some patients newly covered with Medicaid chose to go to other hospitals because of personal preference or greater



proximity to their homes. In addition, these two health systems may have less of an incentive to reduce their uncompensated care costs compared to other hospitals because of the federal subsidies they receive to support the cost of providing care to the uninsured.

- Nineteen for-profit hospitals provided \$88.4 million in uncompensated care in 2017, representing 3.1 percent of total operating costs. **Uncompensated care at for-profit hospitals decreased from 3.1% of operating expenses in 2017 to 1.9% in 2019.**



## Financial Performance of Virginia Hospitals

Hospitals with lower uncompensated care costs tend to perform better financially. Two common measures of financial performance are operating margins and total margins. Operating margins reflect the difference between revenue related to patient care and the costs of patient care, expressed as a proportion of patient-related revenue.<sup>7</sup> Total margin is a more comprehensive measure of profitability, as it includes all revenue sources, including from investments, charitable contributions, and the sales of goods and services not related to patient care. In both measures, positive margins show that revenues exceeded costs – indicating that hospitals are profitable – while negative margins indicate that costs exceeded revenues.

Consistent with the decrease in uncompensated care between 2017 and 2019, hospital financial performance improved, including:

- Both operating and total margins increased during the first year of Medicaid expansion. Operating margins increased from 8.2% in 2018 to 9.7% in 2019 (see Table 1). Total margins increased from 9.6% to 10.6%.
- Operating margins for Critical Access Hospitals improved from -3.6% in 2018 to -2.8% in 2019, although there was an even larger increase before Medicaid expansion (from -8.1% in 2017 to -2.8% in 2019). Among rural hospitals, operating margins dramatically increased from 4.1% in 2018 to 10.1% in 2019.
- The percent of hospitals with negative total margins decreased after Medicaid expansion, from 31% percent of hospitals in 2018 to 24% in 2019.

**Table 1. Financial performance of acute care hospitals in Virginia**

	Operating margins			Total margins			Percent with negative total margins		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
<b>All hospitals</b>	7.9%	8.2%	9.7%	9.6%	8.4%	10.6%	30%	31%	24%
<b>Hospital type</b>									
Acute care	8.1%	8.4%	9.9%	9.7%	8.4%	10.7%	26%	29%	21%
Critical Access Hospitals	-8.1%	-3.6%	-2.8%	-2.8%	1.1%	-1.9%	71%	57%	57%
<b>Ownership</b>									
For-profit	9.8%	12.3%	16.9%	9.9%	12.2%	16.0%	37%	26%	26%
Not-for-profit	7.5%	7.5%	8.4%	9.6%	7.6%	9.6%	28%	33%	23%
<b>Location</b>									
Urban	8.4%	8.5%	9.7%	9.9%	8.7%	10.8%	19%	20%	15%
Rural	1.4%	4.1%	10.1%	5.0%	3.3%	7.3%	54%	54%	42%

## Conclusion

Hospital uncompensated care reflects costs that hospitals incur for providing services to uninsured and many under-insured patients. Medicaid expansion was implemented in Virginia with expectations that the policy will reduce hospital uncompensated care costs by decreasing the number of uninsured in Virginia and increasing hospital revenue from third-party payers, especially Medicaid. Between 2018 and 2019 (the first year of Medicaid expansion), **uncompensated care costs for Virginia's acute care hospitals decreased by 27%, resulting in savings of \$350 million.** As a percent of operating costs, hospital uncompensated care decreased from 6.3% in 2018 to 4.5% in 2019. The decrease in uncompensated care costs occurred broadly across all hospitals, including not-for-profit and for-profit hospitals, urban and rural hospitals, and Critical Access Hospitals. The decrease in uncompensated care is consistent with that experienced by hospitals in other states that expanded Medicaid and with expectations in a previous report on uncompensated care costs for Virginia's hospitals.<sup>8</sup>

Following the expansion of Medicaid coverage, Virginia's acute care hospitals also experienced improved financial performance, including increases in both operating and total margins. Although the analysis in this report did not specifically identify decreasing uncompensated care costs as a cause of the improved financial performance, the findings are consistent with research from other states showing that Medicaid expansion was associated with an improvement in the financial performance of hospitals.<sup>1</sup> Improved financial performance was especially notable among the state's Critical Access Hospitals and rural hospitals, which have struggled financially in the past to a greater degree than hospitals in metropolitan areas, although the improvement in financial performance began in 2018 and therefore is not due entirely to Medicaid expansion.

Based on constant 2019 dollars, hospital uncompensated care costs have decreased from a peak of \$1.54 billion in 2013 to \$950 million in 2019, with the sharpest decrease occurring between 2018 and 2019, the first year of Medicaid expansion. Although many factors contribute to the level of uncompensated care, the steady decrease in uninsured rates following implementation of the Patient Protection and Affordable Care Act in 2014 (ACA) has contributed to the longer-term decrease in uncompensated care costs. Increases in more affordable coverage through the ACA marketplaces beginning in 2014, decreasing unemployment prior to the COVID-19 pandemic, and Medicaid expansion combined to decrease the percent of Virginians ages 0-64 who were uninsured from 14.2% in 2013 to 9.4% in 2019.<sup>9</sup>

Despite the fact that most adults with incomes below 100% of the federal poverty line are eligible for Medicaid expansion, hospitals are likely to continue incurring hospital uncompensated care costs. About one-third of uncompensated care costs in 2019 are in the form of bad debt (\$208 million) which often includes the costs of unpaid copayments or uncovered services for people with insurance coverage. Also, many noncitizens are not eligible for full Medicaid benefits even if they qualify based on their income (although they may be covered for medical emergencies, such as inpatient admissions). In addition, many hospitals are incentivized to continue providing charity care due to COPN requirements in the Commonwealth of Virginia and Disproportionate Share Hospital (DSH) payment structures.<sup>10</sup>

The timeframe examined in this report is the year following expansion, but the report does not include financial changes resulting from the COVID-19 pandemic. The COVID-19 pandemic has presented a number of challenges to hospitals, including an initial steep decrease in elective admissions due to pandemic-related restrictions and bed capacity constraints, as well as possible increases in uninsured patients due to recession-related increases in unemployment. However,

because of Medicaid expansion, the uninsured population is likely smaller than it would have been had Medicaid not expanded eligibility. Because of Medicaid expansion, many patients who otherwise would have become uninsured after losing employment were able to transition to Medicaid coverage, thus mitigating associated increases in uncompensated care. Federal relief funds through the Coronavirus Aid, Relief, and Economic Security (CARES) Act, including Provider Relief Funds, and Coronavirus Relief Funds allocated by Virginia to support Hospital COVID-19 costs were designed to assist hospitals in meeting the needs of the pandemic and to offset pandemic-related financial losses. In addition to this assistance, Medicaid expansion has likely provided an important buffer for many of Virginia's hospitals and allowed them to be in a stronger position to withstand the financial challenges of the pandemic.

## Appendix. Definition of hospital financial measures

**Charity care costs.** The costs of care provided to low income people for which payment is not expected or received. Virginia Health Information (VHI) Hospital Detail Reports include charity care costs for patients at different income levels, including those with family incomes less than 100% of the federal poverty line, between 100-200% of the federal poverty line, and greater than 200% of the federal poverty line.

**Bad debt costs.** The costs of providing services for which payment was expected but not received.

**Total uncompensated care costs.** The sum of bad debt and charity care costs.

**Hospital cost-to-charge ratio.** Charity care is reported as “charges” in the VHI data. A hospital specific cost-to-charge ratio is used to estimate uncompensated care “costs” for hospitals.

*Cost-to-charge ratio = (Total operating expenses - bad debt) / (Gross patient revenue + other operating revenue)*

*Uncompensated care costs = Uncompensated care charges \* cost-to-charge ratio*

**Operating costs.** The sum of labor, non-labor, capital, taxes, and bad debt expense.

**Operating margins.** A ratio that measures profitability based on activities related to patient care.

*(net patient revenue - operating costs) / net patient revenue*

**Total margins.** A ratio that measures profitability more comprehensively as it includes income from sources other than that related to patient care, such as from investments, donations, receipts from parking lots, gift shops, etc...

*(net patient revenue - operating costs + other income) / (net patient revenue + other income)*

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