HFMA Career Center

HFMA CHFP Certification Series
Article 5 - Financial Reporting, Part II
(This is the second of two articles)

The previous article on the *Financial Reporting* module of the certification program provided an overview of accounting standards, basic principles and the financial statements. This article addresses ratio analysis, the "nuts & bolts" of financial reporting. Certification candidates are expected to demonstrate knowledge of and ability to use common financial ratios.

Ratio Analysis the quantitative evaluation of financial statements compared to industry metrics. Many benchmark ratios exist to gauge healthcare organizations and the services they provide. Common ratios that certification candidates are expected to know include:
- Liquidity Ratios
- Profitability Ratios
- Asset Efficiency Ratios
- Capital Structure Ratios
- Operating Indicators

Ratio analysis is most effective when one has national or regional averages or benchmarks against which to compare your organization's performance. Benchmarks can be used as a tool to:
- identify how your organization compares to others
- Provide targets for better performance
- Identify areas where your organization has weaknesses and/or strengths

The following is a listing of the ratios by category that are covered in the certification study materials and examination. The formula is given for the ratio along with the ratio's definition.

I.   **Liquidity Ratios**: Measure the organization's ability to meet current obligations as they mature.
- Current ratio = Current Assets/Current Liabilities
  The current ratio indicates the extent to which current assets cover current liabilities.
- -Quick ratio = (Cash + Marketable Securities + Net Accounts Receivable)/Current Liabilities
  The quick ratio includes only the most liquid assets. A facility is in a better position when quick assets exceed current liabilities

II. **Asset Efficiency Ratios:** Measure the effectiveness of an organization's use of its assets.
- Total Asset Turnover = Total Operating Revenue/ Total Assets
- Inventory Turnover = Total Operating Revenue/ Inventory
  A high value indicates operating efficiency and effective use of the specific asset category.

III **Capital Structure Ratios**: Provide information on the organization's ability to satisfy long-term creditors. Also known as solvency ratios and serve to demonstrate organizations creditworthiness.
- Debt to Capitalization = [Long-term Debt/ (Long-term Debt + Unrestricted Net Assets)] x 100
  A low value implies a sound capital structure; a high value suggests that debt financing must be used to acquiring assets

- Debt Service Coverage = (Excess of revenues over expenses + Depreciation + Interest)/(Principal payment + Interest)
  Measures the ability to meet long-term debt obligations. Higher values preferred.

IV.   -**Operating Indicators**: Industry measures using operational statistics that may not be related to financial statements. Gauges operational efficiency of the organization to others in the industry
- Length of Stay = Total Inpatient Days/Total Discharges;
- Occupancy Rate = Total Inpatient Days in the Period/(Licensed Beds x Days in the period)
- Case Mix Index = Sum of the number of cases in each DRG x the weight for that DRG/Total Cases
- Labor as a % of Operating Revenue: 40.42%-50.76%
- Net Days in Receivable = Total $ in Net Patient Accounts Receivable/Average Net Daily Patient Revenue
- Average Net Daily Patient Revenue = Total Net Patient Revenue/Days in the Period
- Days in Revenue Outstanding = Total $ in Patient Unbilled/ Average Gross Daily Patient Revenue
- Average Gross Daily Patient Revenue = Total Gross Patient Revenue/ Days in the Period
  Goal: Less than total bill hold days
- Cash on Hand: Days Cash on Hand, Short-Term Sources = (Cash + Marketable Securities)/[(Total Expenses – Depreciation Expense)]/365Days
- Cash on Hand, All Sources = (Cash + Marketable Securities + Unrestricted Long-Term Investments/[(Total Expenses – Depreciation Expense)]/365
- Days in Accounts Payable also known as Average Payment Period (Days):
  (Total current liabilities x 365)/ (Total operating expenses – depreciation and amortization expenses)

Ratio analysis allows the organization to compare its performance to other like organizations. Variance analysis permits internal benchmarking at the department level. There are three principle types of variance:
- Price variance: Determines the financial impact of the difference between the actual prices paid for a certain supply and budgeted price for the supply.
- Volume variance: Determines the difference between budgeted and actual units of service provided
- Efficiency variance: Determines the financial impact of a difference between the budgeted labor hours per unit of service and the actual labor used per unit of service.

Financial reporting is the process of gathering financial data derived from operations, interpreting the data for management purposes and formulating standardized and accepted reports of the data to facilitate management decision-making.