

## Additional Talking Points in Response to AHA's Study on Hospital Costs

**AHA Claim: In its chart listing the types of services contributing to the growth in national health spending, AHA depicts “administration and net cost of private health insurance” as a cost driver greater than the costs for nursing home & home health services, physician & clinical services, and hospital care.**

Facts:

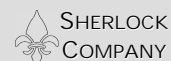
- The PwC analysis unreasonably combines *administrative spending by public programs* with *net cost of private health insurance* to make the comparison between hospital costs and administrative costs. (See slide 1)
- Consolidating both sectors blurs the important distinctions in the collection of administrative cost data and its significance.
- *Net Cost of Private Health Insurance* embraces not only true administrative expenses such as medical management and the private insurer's costs of paying bills; it also takes account of premium taxes, additions to reserves, and other mandatory expenses required by state and federal governments. (See slide 6)
- The difference between net change in hospital costs and private health care administrative costs is *extremely modest*. (See slide 3)
- *Public* program spending on health care administrative expenses grew at a faster rate than *private* administrative costs. (See slides 4)
- The private sector, through careful management, has successfully worked to reduce health care costs.
  - Managed care has been cited by officials at CMS Office of the Actuary as central to limiting health care costs to 13-14% of gross domestic product during the 1990's.

# Hospital versus Administrative Cost Increases, 1996-2001

Douglas B. Sherlock, CFA

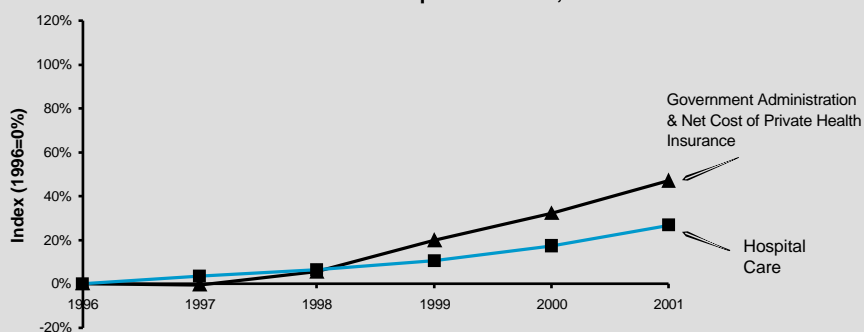
February 25, 2003

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In its report for the AHA, PwC asserts that spending on hospital care has grown more slowly than health care administrative costs...

**Cumulative Annual Percentage Change in National Spending  
for Administrative and Hospital Services, 1996-2001**



Source: Centers for Medicare and Medicaid Services (CMS). Based on PricewaterhouseCoopers study for AHA.

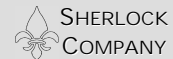
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## This analysis does not address the following...

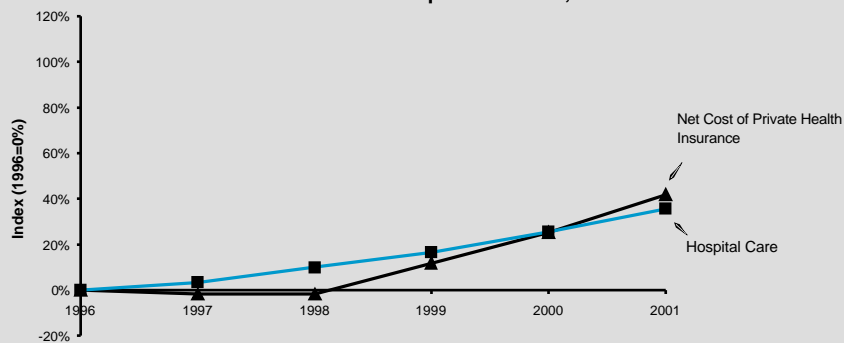
- n By combining public and private sectors, PwC obscures important differences.
- n Public and private administrative costs are not directly comparable: Private administrative costs include “non-administrative” costs (e.g. premium taxes, reserve requirements).
- n Public administration grew at a faster rate than private administrative costs.
- n The private sector, through careful management, has worked to reduce health care costs.

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## The difference in growth between hospital and administrative costs is extremely modest in the Private Sector...

**Cumulative Annual Percentage Change in National Spending for Administrative and Hospital Services, 1996-2001**



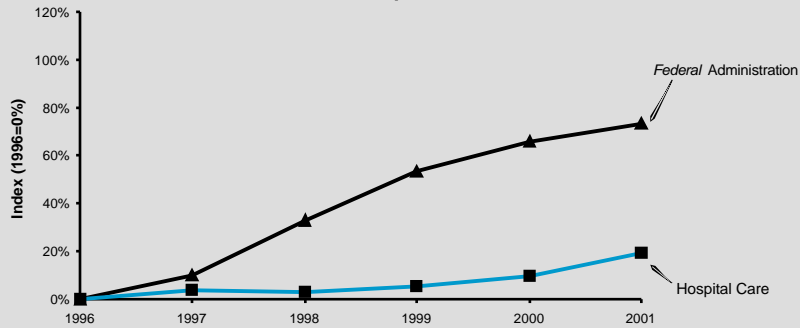
Source: Centers for Medicare and Medicaid Services (CMS).

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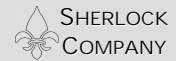


The difference is much more pronounced in Public Sector, especially in administrative spending by Federal programs.

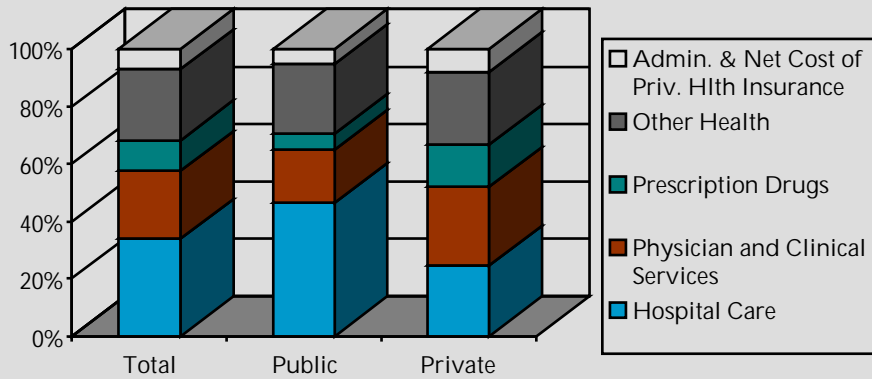
**Cumulative Annual Percentage Change in National Spending for Administrative and Hospital Services, 1996-2001**



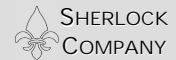
Source: Centers for Medicare and Medicaid Services (CMS).



Administration is Modest Compared to Other Health Care Costs



Source: Centers for Medicare and Medicaid Services (CMS) 2001 Data.



## CMS Calculates Administrative Costs for Private Health Plans as ...

Normal Administrative Costs ...

### Plus "Costs" Not Strictly Related to Administration

- n Net additions to reserves and profits or losses.
- n Premium taxes.

**Unlike Medicare, private companies are  
legally obligated to remain solvent.**

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Sherlock Company provides financial advisory services to health plans and their stakeholders. We publish the leading source of independent administrative cost benchmarks, the SEER studies. These benchmarks are comprised of data from health plans serving 25% of all Americans.

Sherlock Company also provides corporate finance services to health plans, including those related to capital formation and business combinations. We also publish PULSE, the leading financially oriented newsletter covering health plans.

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