This week’s courseware introduced the concept of financial and operating ratios as performance measurement tools. In this comparative analysis, Team C analyzed both the 2008 –2009 unaudited and audited financial statements for Patton-Fuller Hospital and computed the eight ratios—as shown in Chapter 11. The eight ratios widely used in health care consist of: four liquidity types, two solvency types, and two profitability types. Each team member was assigned two ratios to compute, analyze the result, provide feedback and recommended plans to present to the hospital Board and the next years and proceeding five years.

Liquidity ratios are the ratios that measure the ability of a healthcare organization or private practice financial ability to “be liquid”: in order words, have assets that can be liquidated. The liquidity ratios are a result of dividing cash and other liquid assets by the short term borrowings and current liabilities. If the value is greater than 1, it means the short term obligations are fully covered. Generally, the higher the liquidity ratios are, the higher the margin of safety that the organization possess to meet its current liabilities.

Patton-Fuller Hospital Liquidity Ratios

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Unaudited Balance Sheets | 2009 | 2008 | Change | Percent Change |
|  |  |  |  |  |
| Current Assets | $ 128,867.00 | $130,026.00 | (1,159.00) | -2% |
| Current Liabilities | $ 23,807.00 | $ 8,380.00 | $15,427.00 | 184% increase |
|  |  |  |  |  |
| Current Ratio  Quick Ratio | 5.41:1  3.48 | 15.52:1  9.49 |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| Audited Balance Sheets | 2009 | 2008 | Change Percent |
|  |  |  |  |
| Current Assets | $ 127,867.00 | $ 130,026.00 | (2, 159) -2 % decrease |
| Current Liabilities | $ 23,807 | $ 8,380.00 | 184% increase |
|  |  |  |  |
| Current Ratio  Quick Ratio | 5.37:1  3.44 | 15.52:1  9.49 |  |

Comments:

The net loss of the organization went down in 2009 as compared to 2008 by 98%. It was due to increase in revenues by 10%. All expenses were increased between 3 to 5%, except for depreciation and bad debts expense. They have increased by 44% and 11% respectively, in 2009 as compared to 2008. The increase in depreciation expense is due to increase in fixed assets in 2009 as compared to 2008. The increase in bad debt expense is due to increase in account receivable in 2009 as compared to 2008. The interest income was also decreased by 123%, and it may be due to more interest expenses in 2009 as compared to 2008. If it would have been fewer in 2009 as compared to previous year of 2008 then the net loss might have been converted into net income. The decrease in net income has affected the return on assets ratio and return equity ratio in both years; they are around 0%in 2009 and -3% in 2008 for both ratios. The ratio has been shifted from negative to almost 0%, due to increase in revenues and net income.

The increase in assets in the year 2009 is 7%, which is due to increase in account receivable by 56%, inventories by 100% and increase in property plant and equipment by 41%. The hospital might have provided more credit to customer to raise the revenues and also more investment in fixed assets and inventories to enhance the revenues. It seems that the organizat— ion is successful but not completely as they could raise the revenues only by 10%. The increase in fixed assets and current assets have been financed by debt financing, which is evident from increase in account payable and accrued expenses by 120% and net long term debt has increased by 114% as compared to previous year. The decrease in retained earnings by hefty amount of 63% shows that company is relying more on debt financing, therefore the debt to total assets and debt to total assets ratios have been heavily disturbed in 2009 as compared to 2008. In 2008 39% of total assets were financed from debt financing while in 2009, it rose to 79% showing a hefty increase of 102%. In 2008 the debt to equity ratio has also shown the same pattern rather worse situation than debt to total assets, in 2008 it was 64% but rose to 368%, showing a drastic increase of 478% which is main cause of net interest expense in 2009 which was net interest income 2008.

The management has to make sure that they fully utilize the resources in forthcoming period to make sure that the revenues are enough to create net income; otherwise they should try to reduce the investment, especially in account receivable and inventories. For this purpose, they must concentrate on the return on total assets which is the combination of both profit margin and total assets turnover and also pay attention to return equity ratio. For control purpose they can look what are done by other organizations of the same sector. The debt financing should be reduced and try to finance from equity which will also reduce the interest expense and also the profit margin of the organization. They should try to control debt to total assets ratio and debt to equity ratio. Once again for this purpose they can look into the organizations of the same industry and compare their capital structure with Patton capital structure.

Days Cash on Hand Ratio (DCOH):

Based upon the audited financial statements for Patton Fuller Community Hospital, the Days Cash on Hand (DCOH) ratio does show a decrease due to the cash equivalents from 2008 to 2009. In 2008 the ratio was 34.92 and in 2009 the ratio was 18.16, this show’s a difference of 16.76 within a 365 day period. This was found by the auditors during a discrepancy that was identified during an audit in the line item, this discrepancy was 1,000,000.00. This caused the accounts to break even which eventually resulted in the increase of the total expenses. Luckily, Patton Fuller will break even because of the explanation within the next ratio.

Days Receivables:

The Days Receivables actually shows an increase in the net receivables from 2008 and 2009. In 2008 the ratio was 32.85 and in 2009 the ratio was 47.45, this shows an increase by 14.65 within a 365 day period; Patton-Fuller had a profitable year between 2008 and 2009. Team C recommends that the hospital board should follow guidelines to ensure that there is the possibility of any future discrepancies.

Debt service coverage ratio (DSCR)

In 2009 the DSCR decreased to 2.76% from 10.58% in 2008, which indicates that the organization is in a better position to repay outstanding debts, and have the ability to generate enough income within its operations to cover expenses on debt in the future. With the operating income being positive, the comparison between 2009 and 2008 indicates the possibility of a considerable change in the organizations net income and interest expenses.

Liabilities to fund balance:

The liability to fund ratio raised in 2009 to 3.65% from 0.64% in 2008, which indicated that the organization have gained some financial strength, and have a considerable amount of cash flow and profitable operating margin which puts the organization in a better position to establish additional credit.

The operating margin is the measurement of what proportion of the Patton-Fuller Community Hospital revenue is left over after paying for operating costs such as wages and raw materials. It can be calculated by dividing the operating income or operating profit, during the 2008 and 2009 time period by its total operating revenue during the same time period. Operating income refers to the profit that the Patton-Fuller Community Hospital will have after subtracting operating expenses like wages. Total operating revenue refers to the total amount received for services provided or charged for.

The return on total assets is represented as earnings before interest and taxes or EBIT divided by the total assets. Return on total assets or ROTA is expressed as a ratio that measures the Patton-Fuller Community Hospital earnings before interest and taxes or EBIT against its total net assets. The ratio is considered an indicator of how effectively the hospital is using its assets to generate earnings before financial obligations must be settled or paid.