



American Academy  
of Value Based Care

# Observation vs. Inpatient Admission

## Quick Reference Guide

2025

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## 1. FINANCIAL IMPACT OVERVIEW

Appropriate use of observation status is a key driver of hospital cost savings and compliance. Aligning admissions with the Two-Midnight Rule reduces unnecessary inpatient stays while maintaining high-quality care and ensuring regulatory accuracy.

### Core Savings Opportunity

- Each appropriate inpatient-to-observation conversion can yield up to **\$10,000** in avoided inpatient costs<sup>1</sup>
- **National Averages:**
- **Inpatient stay:** ~ \$11,000–\$14,000 per discharge (CDC)<sup>1,2</sup>
- **Observation stay:** ~ \$2,000–\$5,000 (medicare)<sup>2</sup>
- **Average hospital expense:** ~ \$3,000 per inpatient day (2023), fluctuates significantly by state, with some states averaging over \$4,000 per day<sup>3</sup>

### Performance Opportunity

- **Cost Efficiency:** Protocol-driven observation care reduces total cost by 15–30 % compared with short-stay inpatient admissions<sup>4</sup>
- An **8 percent increase** in observation utilization correlates to an estimated \$0.64 PMPM financial improvement
- **National Savings:** Potential national cost savings of \$950 million annually.<sup>4</sup>
- **Shorter Stays:** A 23%--38% shorter length-of-stay in the hospital<sup>4</sup>

### Regulatory Framework — Two-Midnight Rule<sup>4</sup>

- **Inpatient admission** requires a physician's expectation that medically necessary hospital services will span **at least two midnights** (≥48 hours)
- **Observation status** applies when the expected hospital stay is **less than two midnights** or when clinical uncertainty requires short-term monitoring.

### Cost Comparison<sup>1-5</sup>

Category	Inpatient Admission	Observation Stay
Average Cost	~\$13,000	~ \$3,000
Patient Responsibility (Medicare 2025)	\$1,792 Part A deductible	20% Part B coinsurance
SNF Eligibility	Counts toward 3-day SNF requirement	Does <i>not</i> count toward 3-day SNF requirement
Billing Basis	Medicare Part A (DRG-based)	Medicare Part B (CPT/OPPS)
Regulatory Basis	Two-Midnight Rule: Physician expects a 2 midnights of hospital-level care	Used when < 2 midnights expected or for short-term monitoring

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