
AAVBC

American Academy
of Value Based Care

Observation vs. Inpatient Admission

Quick Reference Guide

2025

Observation vs. Inpatient Admission Quick Reference Guide

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 costs¹
- **National Averages:**
- **Inpatient stay:** ≈ \$11,000–\$14,000 per discharge (CDC)^{1, 2}
- **Observation stay:** ≈ \$2,000–\$5,000 (medicare)²
- **Average hospital expense:** ≈ \$3,000 per inpatient day (2023), fluctuates significantly by state, with some states averaging over \$4,000 per day³

Performance Opportunity

- **Cost Efficiency:** Protocol-driven observation care reduces total cost by 15–30 % compared with short-stay inpatient admissions⁴
- 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.⁴
- **Shorter Stays:** A 23%--38% shorter length-of-stay in the hospital⁴

Regulatory Framework — Two-Midnight Rule⁴

- **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 Comparison¹⁻⁵

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

AAVBC Knowledge Hub Premium Content Access

Continue reading your guide
with an AAVBC subscription

[Subscribe Now](#)

Already a subscriber? [Sign in](#)

Limited offer

Basic Membership

Free

Includes access to downloadable Quick Reference Guides, mailing list for industry updates/medical information, research toolkits, AAVBC events and so much more!

Cancel at any time