Cost Accounting: Bridging the Gap Between Where You Are and Where You Should Be

By Catherine Savage and Curtis Bryan

Start with the end goal in mind.

"Cost accounting is your friend." Five years ago, Michael Porter and Thomas Lee, MD, included that statement in their popular *Harvard Business Review* article "The Strategy that Will Fix Health Care." Their argument was that when true costs are understood, clinicians will work with administrators to improve the value of care. The flip side of their argument was that when organizations don't understand their true costs of care, they are flying blind when it comes to improving value.

Jump forward five years. Has the cost transformation described by Porter and Lee resulted in sophisticated and effective hospital cost accounting systems? Kaufman Hall's 2018 survey of nearly 190 healthcare executives indicates that while 86 percent say that cost transformation is a significant to very significant need in their organizations, 71 percent of respondents do not have a high degree of confidence in the accuracy of results produced by their current cost accounting solutions.

Without trust in cost information, transformation initiatives do not benefit from the visibility of critical data used by executives to make key decisions, such as what

service lines merit more or less investment and which physician enterprise expense items warrant additional analysis.

From Traditional to Best Practice

When evaluating what hospitals need from their cost accounting systems, starting with the end goal in mind is beneficial. The cost accounting system end goal is a system that enables reporting across the care continuum, as well as across multiple financial functions, that hospital executives can stand by and take action on.

There are differences between traditional, hospital-centric cost accounting systems and best practice accounting systems (see exhibit at right). The former lack the flexibility needed to accommodate changing environments and organizations. Professional and payer billing activity and other data from across the care continuum often are not incorporated into costing, and while processes may be efficient, resulting analytics may be less meaningful. The hallmarks of best practice cost accounting systems—reliable, repeatable, transparent, flexible, extendable, and accurate—address traditional solution limitations and help organizations reach the end goal of actionable reporting to drive operational and strategic decision-making in today's complex environments.

The MultiCare Journey

To help maintain its successful trajectory created by rapid growth through acquisitions and cost-reduction initiatives of $100 million per year, MultiCare Health System required a costing approach focused on analytics. The Tacoma-based system's seven adult hospitals, one pediatric hospital, and more than 200 clinics serve the greater Puget Sound and Spokane regions.

Similar to other hospitals across the country, MultiCare wanted to integrate multiple legacy platforms, including budgeting, management reporting, rolling forecasting, costing, decision support, financial planning, and capital planning/tracking to access merged data. By creating a single source of truth, MultiCare aimed to have coordinated oversight of all financial data, including security and design, and provide a consistent training curriculum for its finance team. Ultimately, its goal was to prepare data for distribution across the organization, knowing that formerly disparate systems were fully integrated.

MultiCare's new costing process reflects the high-level steps the system uses to determine unit cost, which is then applied to the patient encounter level (see the exhibit below). The end result is patient-level cost, with analytics and reporting drawn from a single source.

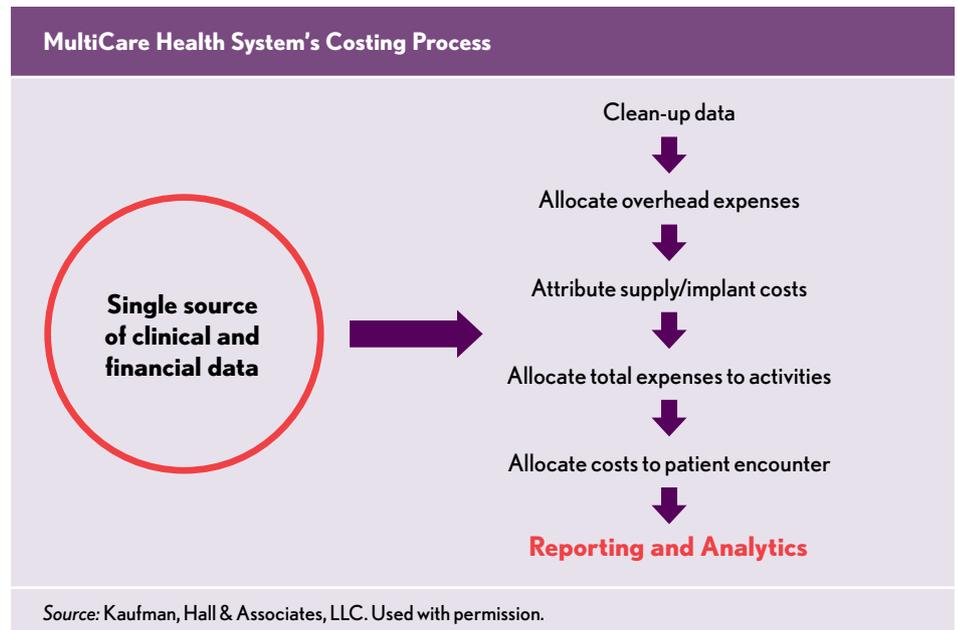The quarterly cost calculation process includes several data preparation activities—determining account and department types, grouping accounts into cost categories, preparing departmental costs, and assigning methods for cost assignments.

MultiCare splits accounts into fixed and variable groups and the department types into direct and indirect groups to facilitate accurate costing and informative reporting. Next, accounts are grouped into summarized cost categories to help with reporting.
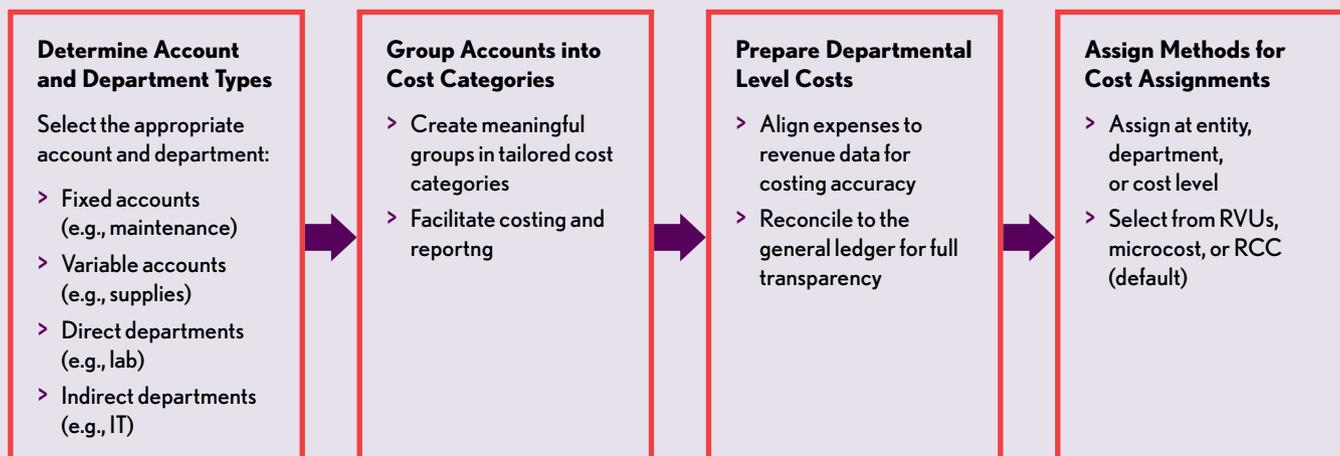
Once this preliminary work is complete, MultiCare processes needed expense reclassificationses and indirect allocations (see exhibit on page 3). For detailed

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Traditional Versus Best Practice Cost Accounting

Traditional Cost Accounting	Best Practice Cost Accounting
> Restricts ability to pull data from the full care continuum	> Provides **reliable** information on a monthly or quarterly basis by incorporating a **repeatable** process
> Unable to adapt to new or unique needs	> Features full **transparency** from start to finish to get fully allocated costs
> Sacrifices validity for efficiency	> Is **flexible and extendable** to meet needs to reclassify, change cost categories, and report at different levels
> Requires high levels of resources and time	> Promotes confidence that analytics are **accurate** and can be used to drive strategic and capital decision making
> Lacks transparency, which leads to limited trust	
> Fails to produce data that can be leveraged for decision making	

Source: Kaufman, Hall & Associates, LLC. Used with permission.

MultiCare Health System's Costing Process

Single source of clinical and financial data →

Clean-up data
↓
Allocate overhead expenses
↓
Attribute supply/implant costs
↓
Allocate total expenses to activities
↓
Allocate costs to patient encounter
↓
Reporting and Analytics

Source: Kaufman, Hall & Associates, LLC. Used with permission.

MultiCare Health System's Approach to Preparing for Quarterly Cost Processing

Determine Account and Department Types

Select the appropriate account and department:

> Fixed accounts (e.g., maintenance)
> Variable accounts (e.g., supplies)
> Direct departments (e.g., lab)
> Indirect departments (e.g., IT)

Group Accounts into Cost Categories

> Create meaningful groups in tailored cost categories
> Facilitate costing and reportng

Prepare Departmental Level Costs

> Align expenses to revenue data for costing accuracy
> Reconcile to the general ledger for full transparency

Assign Methods for Cost Assignments

> Assign at entity, department, or cost level
> Select from RVUs, microcost, or RCC (default)

Source: Kaufman, Hall & Associates, LLC. Used with permission.

RVU-based costing, MultiCare focuses on labor, supplies, implants, drugs, and purchased services. These areas provide the biggest return on the costing team's time investment. The resulting unit cost calculations are reliable and reflect MultiCare's operational structure. They are then applied to encounters for the end goal of reporting.

With costing data for the full organization in a single database and a consistent and detailed costing approach, MultiCare also can apply cost data to strategic reporting to assess organizational initiatives. For example, with the ability to examine implant costs, which are variable among providers, decision support reports can be created to inform physicians of the profitability of their procedures, using accurate and consistent data across entities and providers instead of apples-to-oranges comparisons using inconsistent methodologies.

In addition, MultiCare can track costs in both clinic and hospital settings so that profitability across the care continuum is evaluated. Most important, MultiCare is not just calculating costs, but actually using the data to inform decisions. The system's decision support team creates timely and effective routine and ad hoc reports. They are able to leverage a costing solution with the hallmarks of best practice cost accounting systems and then use the reporting to drive strategic decision-making. ✦

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