

THE IMPORTANCE OF ACCURATE COST ACCOUNTING IN HEALTHCARE DELIVERY

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I once worked in a healthcare system where our senior leadership team was taken to task by a quality consultant for not knowing basic facts about our clinical outcomes, such as mortality rates, complication rates, readmission rates, etc.

I now work as a financial healthcare consultant and am continuously disappointed in how little most health system leaders know about their basic cost structure. I’m not talking about budgeted to actual expenses, which most CFOs can tell you down to the penny. Rather, what does it cost to perform the most common processes and procedures in the organization, such as taking out someone’s gallbladder, delivering a baby, treating an episode of pneumonia, or caring for a diabetic patient?

Why is this important? Well, the name of the game today in the healthcare industry is Value, i.e., quality per unit of cost. If the denominator in the value equation is unknown, you can’t quantify the value you are providing to the consumer.

Furthermore, if more and more reimbursements are going to be “value-based” then knowing the cost component of the value equation for specific services will be crucial as you negotiate or set prices.

Finally, the consumer today is increasingly demanding high-value healthcare services, as evidenced by the advent of value-based reimbursements (e.g., bundled payments, shared savings agreements, partial or full capitation payments) that are coming down the pike, fast and furious, from both government and commercial payers. Even large self-insured employers and individual purchasers of health insurance on the Obamacare Exchanges are demanding higher value, especially now that many of them are responsible for higher out-of-pocket expenses. Quite simply, if you can’t demonstrate value, by accurately measuring both quality and cost, you won’t be able to compete for value-based payments, which progressively are becoming the norm.

So how do we fix this matter and empower healthcare providers with more accurate knowledge around costs?

First, providers need to measure costs around services or clinical conditions as opposed to measuring expenses by department or location. This determination is best

done using an activity-based cost accounting methodology, such as Time-Driven Activity-Based Cost Accounting (TDABC), as popularized by Kaplan and Porter at the Harvard Business School. TDABC has been found to be much more accurate than proxies for cost accounting used in many organizations, such as average charge-to-cost ratios (CCRs) or relative value units (RVUs).

Next, providers need to apply TDABC to their most common care processes and procedures, such as performing an office visit on a diabetic patient in a primary care practice, performing a total joint replacement surgery on an orthopedic patient, or managing a heart failure patient over a set period.

Will it be difficult for providers to adopt more sophisticated cost accounting methodologies? Yes, but there are IT systems that can automate many of the steps in the process and produce near real-time results.

Ultimately, providers need to use both their quality and cost outcome data to practice data-driven, continuous process improvement, so that the processes and procedures under study are refined over time to produce higher and higher value for the patients served. This information will convert those who adopt this practice into learning organizations and allow them to iterate care over time to continuously improve the value they are providing for the patients they serve. Data-driven process improvement, however, has to start with accurate data, not just for quality outcomes but also for costs.

In conclusion, Coker recommends that with cost accounting, you start small and focus on those activities that you do most frequently. Over time, the cost accounting process can be spread, and more data can be made available to use in eliminating non-value-added costs, negotiating payments, and, most of all, providing higher value services!

To learn more about how Coker can assist you and your organization, please contact Ellis “Mac” Knight, MD, Senior Vice President/CMO at mknight@cokergroup.com or by calling 678-832-2021.