

Why Advanced Cost Accounting is Becoming the Next 'Killer App' for CFOs

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As the business model of healthcare continues its long-term shift away from fee-for-service to fee-for-value, CFOs are starting to shift their focus from strictly driving the top line to figuring out how to help their organizations drive the bottom line in a value-based structure.

While revenue cycle management has been the required application to invest in and deploy for the last 20 years, advanced cost accounting may be the "killer app" for the next 20 years.

And it's easy to see why. A recent survey of 100 hospital and healthcare delivery system executives conducted by Strata Decision Technology and Becker's Healthcare, found 90 percent of those responsible for care don't know the cost of it. This gap is driving the rapid adoption of more advanced cost accounting applications that make data more accurate, accessible and actionable.

CFOs are now recognizing this simple fatal flaw — how can you manage cost if the people responsible for it have no access to information? Recognizing that over \$3.2 trillion is spent on healthcare in the U.S. every year, with over \$1 trillion flowing through hospitals, the lack of tools to effectively understand and manage the cost of care represents a black hole of stunning proportions.

The end result is most CFOs are left to manage the cost crisis in the pitch dark. The typical CFO for a U.S. healthcare delivery system is managing the financial engine for a multi-billion dollar business with thousands of employees and razor-thin operating margins that average 2 percent. They are seeing their core inpatient business declining in volume by close to 3 percent per year over the last five years. With that said, their biggest challenge ahead is that their already shaky business model is being flipped upside down with the introduction of capitated and bundled payment programs that hold hospital systems accountable for taking on the risk of a fixed top line.

With margins this thin, growth this challenging and a future this uncertain, you would quickly conclude that understanding and managing cost would be mission critical.

Surprisingly, over 90 percent of U.S. hospitals either don't have a cost accounting system or have one that is outdated and insufficient. And physicians and other clinicians whose decisions control roughly 80 percent of a hospital's total spending are provided with little to no information on cost.

The end result is a lack of accurate and actionable cost data that has made consistently understanding, managing and driving out cost close to impossible.

The need to understand cost is increasing due to market pressures. Hospital systems' growing participation in capitated or risk-based payment models is driving organizations to see value in gaining a deeper understanding of their clinical data and true costs, as well as how those data sets interact. In these new models, the need to understand margin is very clear. Without accurate costing data, healthcare organizations are flying blind in these agreements and deciding how to improve processes, redesign care and drive value is extraordinarily difficult.

Recognizing the operational issues that need to be solved and the strategic value of understanding cost, hospital system CFOs are moving quickly to implement advanced cost accounting applications that provide accurate, accessible and actionable information on the cost of care delivery for their organization.

The Strata/Becker's survey and associated research identified three common issues in hospital cost accounting that need to be addressed:

1. Current cost accounting methods are seen as inaccurate, and the information isn't used.
2. Most hospital systems aren't able to define cost across the care continuum.
3. Most hospital systems don't trust their data.

Ensuring financial leaders use high-quality data to support clinical and strategic decision making is critical. Feeding low-quality data into analytics or using inaccurate data to drive decision making can produce the wrong conclusion and negatively affect patient care and financial performance. With that said, many hospitals still continue to run a costing process, produce data no one uses and waste time and resources.

Over the last five years, legacy cost accounting systems are increasingly being replaced by advanced cost accounting applications that provide accurate, accessible and actionable cost information. Advanced cost accounting includes a set of methodologies including time-based, activity-based costing (ABC), as well as supply-based and pharmacy-based costing, cost study and relative value unit (RVU) based costing.

One methodology alone is not sufficient to consistently and accurately understand cost in healthcare. Healthcare is very different from other industries due to the data available, the variety of patient conditions, physician preferences, site of care, as well as the non-homogeneity of expenses and how they are tracked. Cost accounting needs to be accurate and comprehensive, but most importantly it has to be a scalable process.

Advanced cost accounting helps address these issues. Expenses are categorized and attributed to patients based on the most practical and accurate methodology available to a provider organization. It provides a library of approaches based on the setting as well as data available to automate the process, such as EHR-based time stamps. The focus is on all the potential opportunities for identifying variation while ensuring the effort is worth the output. Leveraging a data-driven approach reduces the need for manual intervention to identify costs and enables organizations to identify true cost variation for every patient.

The Strata/Becker's research identified the key factors driving hospital systems to adopt advanced cost accounting solutions in preparation for value-based medicine.

1. Understanding true margins.
2. Identifying opportunities to reduce cost.
3. Viewing the total cost of care across the continuum from both inpatient and outpatient settings.
4. Sharing the financial impact of harm events and variations in clinical care.
5. Accessing accurate cost information more quickly and frequently.
6. Creating an integrated approach to financial planning and performance.

In the past, cost accounting has been undervalued and underutilized as accuracy and accessibility of information on cost wasn't seen as a necessity in traditional volume-driven payment models. This is not the case in risk- or value-based medicine. Without credible and detailed cost data, it will be extraordinarily difficult for healthcare organizations to strategically manage their operations and minimize the impact of declining reimbursement.

With close to 90 percent of healthcare leaders operating in the dark on cost, leveraging data from advanced cost accounting that is comprehensive, accurate and accessible is mission critical in helping providers collaborate and make more informed decisions, bend the cost curve, and ultimately deliver more value to the patients and the community that they serve. This is why advanced cost accounting is quickly becoming the next "killer app" for hospital CFOs.