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How Robust Cost Accounting Enhances the Planning Process

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At Nebraska Medicine, department managers have a strong incentive to keep their cost information up-to-date because it drives their budgets.

Leaders at Omaha-based Nebraska Medicine, a two-hospital system with 60 clinics and $1.5 billion in net revenue, strive to protect their 4 percent margin against threats like the rising self-pay patient population and recent cuts in 340B drug reimbursement.

"With the volatility in health care in general—especially in reimbursement where we are experiencing a changing payer mix and pressure from commercial payers, as well as uncertainty with 340B—we have to be agile," says Stephanie Daubert, CFO.

To help reduce the organization's expense base and ensure its financial stability, leaders at Nebraska Medicine rely on activity-based budgeting, an advanced planning approach that uses true, procedure-level cost data to produce more precise budgets, combined with technology to automate and streamline the process.

Simply put, activity-based budgeting is a framework that creates a tighter link between the detailed activities that occur in a department to the costs and revenue they generate, resulting in a more accurate budget. How it works: In activity-based budgeting, clinical service line encounters are translated to the department at the procedure level based on past, patient-level utilization patterns. Then cost information derived from sophisticated and advanced costing methodologies, such as activity based costing, relative value unit (RVU) studies, and supply acquisition cost, is applied to generate a highly accurate cost profile and budget.

At Nebraska Medicine, leaders leverage the same platform they use for cost accounting and patient reporting to develop a detailed, activity-based budgeting baseline each month. For labor, leaders use technical estimates to develop RVUs rather than time studies. Although the detailed nature of this approach may seem daunting, much of the work is automated through their cost accounting system, so additional time and staff are not needed.

Enhancing Engagement and Accountability

In activity-based budgeting, procedure volumes drive each department's variable costs, such as labor and supplies. This provides an incentive for department managers to ensure their cost accounting data is as precise as possible.

"People are invested in this because they recognize it will be the method in which they can have additional FTEs if their volumes justify it," says Mary Jo Brummel, director of budget, decision support, and financial analysis. Conversely, department managers cannot modify expenses or revenues in their budgets when utilization data does not support it.

In this way, activity-based budgeting provides a measuring stick that moves when volumes rise or fall, giving departments a helpful way to gauge if they are on track or not. Such a tool can be especially valuable for department managers who may not have a strong business background.

Using this approach, Nebraska Medicine's surgical department has run continually within 1 percent of its supply budget. "They are able to identify when they are not billing for large dollar items because when they don't bill, they don't get flex dollars to pay for the implants in their department," Brummel says.

Brummel believes activity-based budgeting empowers leaders to answer questions quickly and objectively, such as why revenue might be down even when surgical cases were in

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line with the budget. In this case, the finance team can review the mix of cases and then discuss potential remedies with department managers if they fall behind.

Given that activity-based budgeting relies upon having accurate cost data, the approach often "shines a spotlight" on data integrity and even operational issues, such as lost charges. In one department, managers were concerned about their labor flexing down and uncovered a glitch in their electronic health record that caused some radiology charges to get clogged in a work queue.

The approach also helps finance leaders discover when managers misallocate RVU assignments. At Nebraska Medicine, leaders found a million-dollar misallocation caused by an analyst who assigned advanced practice NICU provider RVUs to professional fees, rather than hospital fees, creating what appeared to be a huge loss until the problem was corrected.

Providing Ongoing Education and Support

Through activity-based budgeting, leaders at Nebraska Medicine have realized a virtuous cycle between cost accounting and planning, as their managers are incentivized to review their cost information regularly, knowing the cost data will be used to generate their performance targets and budget.

Although activity-based budgeting may be perceived as more time consuming than traditional budgeting techniques, the approach is quite practical if leaders automate it through their cost accounting system. In fact, two finance leaders at Nebraska Medicine can build a detailed activity-based budget baseline in less than three weeks, provided they have established the service line volumes and methodologies.

"For a relatively simple department that has 25 to 30 charge codes, it probably requires a two- to three-hour investment in cost accounting education followed with another two- to three-hour discussion on labor, supplies, etc., to develop RVUs used for the cost accounting," Daubert says.

After that, the finance team should continue to offer guidance to department managers to help them make the most of the approach. "What you can't underestimate is the need for ongoing education and reinforcement of cost accounting principles with all of the managers," Daubert says. When working with these leaders, her team stresses the benefits that activity-based budgeting will have on their performance. They also emphasize how the approach can help managers focus their time on process and ratio improvements instead of trying to uncover data to explain variances.

To help build greater accountability among department managers, the finance team at Nebraska Medicine uses a management reporting tool that provides detailed, drillable income statements. Such reports also help launch productive conversations between the finance team and department leadership on opportunities for improvement.

Lessons Learned

Daubert and Brummel offer the following advice for other organizations looking to implement activity-based budgeting.

Get C-suite support. "To start down this road, your CFO has to believe that this is the right thing to do," Daubert says.

Trust your cost accounting data. The most important prerequisite for activity-based budgeting is accurate cost data, which requires constant nurturing and feeding. "You've got to have good patient information and cost accounting that you buy into," Brummel says.

Engage department leaders with cost data that drives clinical improvements. Department managers may be more inspired to ensure the accuracy of their cost data if it helps to drive clinical improvements as well. For example, physicians and pharmacy leaders at Nebraska Medicine recently reviewed some of their most costly drugs. Together, they developed an intervention in November to limit the utilization of one expensive drug only when needed, saving $700,000 through the remainder of FY 2018.

Be committed to maintaining RVUs. "You can't put them in once and not touch them for three years," Brummel says. This leads to incorrect flex budgets and inaccurate patient accounting.

Brummel recommends using RVUs unless a department is new. In this case, leaders can use cost-to-charge ratios for the first year.

Build reasonability checking and collaboration into the process. Leaders at Nebraska maintain 32 cost components each month, although most departments do not use more than eight. Analysts in the decision support and accounting team work with managers to assign RVUs to any new activity charge codes on a monthly basis. This gives the finance team an opportunity to review and improve the accuracy of data, if needed.

Every month, Nebraska Medicine's manager of costing and budgeting reviews the flex budgets for reasonableness to ensure the departments do not receive too much—or too little—money. "If a department is flexing up by four times the amount of their static budget, and the charges are not going up at the same level, a red flag goes up and you can automatically spot the number in the costing," Brummel says.

Create meaningful incentives. Financial accountability should be part of managers' performance appraisal process so they are incentivized to ensure their cost information is up-to-date and accurate.

Nebraska Medicine recently added contribution margin targets for vice presidents that will be tied to an incentive plan.

Don't let perfect get in the way of good enough. Leaders should be conscientious when embarking on activity-based budgeting, such as by using detailed RVUs rather than a single unit of service. But they should remember to focus on what matters most. "It's easy to get lost in the details," Daubert says. "Make sure that you are not spending too much time on something that doesn't have a huge impact."

Achieving the Right Balance

As leaders at Nebraska Medicine continue to embrace the detailed planning approach they have found with activity-based budgeting, they also have begun using high-level rolling forecasts as a complementary planning tool.

"We want to be able to respond more quickly to changing financial conditions," Daubert says. Based on their first rolling forecast, leaders at Nebraska Medicine are already looking at ways to reduce expenses to keep their health system strong as downward pressure on margins continues.

Although activity-based budgeting may be more rigorous than needed for some organizations, others may find it can be an invaluable way for leaders to assess—and reassess—their strategies, Brummel says. "As an organization, you have to decide if you want detailed objective data to measure against or not," she says. "If you're comfortable rolling with the punches and accepting what is happening as just inevitable, you might not need this. But we really appreciate knowing if we are off the mark."