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Your Old Costing Methods Won't Cut It Under Value-Based Care

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Effectively managing expenses is key to remaining profitable in any value-based reimbursement model. Because revenue is fixed, a healthcare organization must be vigilant about cost control to maintain consistent margins.

Looking further upstream, a hospital or health system must have a true understanding of what their expenses are to ensure any value-based payments will adequately cover their costs. Unfortunately, the traditional methods used for capturing, quantifying, and reducing costs are not precise or insightful enough to give organizations a complete picture of what's happening in their facilities. This lack of clarity can impair decision-making and prevent success with an alternative payment arrangement.

Traditional Costing Methods Fall Short

Hospitals and health systems typically follow any of three strategies to manage costs:

- Reducing volume (eliminating services or lowering capacity)
- Cutting budgets (usually aimed at labor or supplies), or
- Limiting variation

Historically, healthcare organizations have used ratio of costs to charges (RCC) or relative-value units (RVUs) to make cost-cutting decisions within these three strategies.

"Unfortunately, when you want to cut services, reduce the number of staffed beds or make other budget cuts, you lose accuracy with RCC or RVUs, and you may decide to stop or cut something you shouldn't," says Naveed Ismail, Vice President of Customer Management at The Craneware Group.

Consider the hospital that uses RCC to measure costs and decide whether to eliminate a certain service. Charges are designed to be only as precise as necessary to track services billed via CPT code. The service may be valued arbitrarily, is rarely updated, and doesn't typically reflect everything that occurs to the patient.

"Using RCCs can lead the hospital to believe the service is not profitable when it actually is," Ismail says. "And decisions made to eliminate that service can have long-lasting, detrimental effects."

Ratio of cost to charges doesn't consider all the activities and services that occur in patient care, only the services that are charged. Since there are a lot of shortcuts in the way that organizations create charges to simplify the chargemaster, the accuracy of these activities using RCC is suspect at best.

Although relative value units are better than RCCs, they're still not ideal for making cost-cutting decisions.

"RVUs are based on CPT codes," says Ismail. "They capture information at the procedure level, but there is no breakdown of activity within the CPT codes. There's a lot they simply miss."

For example, a spinal fusion might have two or three different CPT codes that represent the different sub-procedures involved in the overall case. These codes reflect what the surgeon is doing, but they don't quantify the many other surrounding activities, or the time and effort of the other clinical staff.

Let's say you have two physicians plus surgical teams, both performing an anterior cervical discectomy and fusion spinal surgery on similar patients. One takes four hours in the surgical suite, while the other takes two hours. An RVU methodology would treat those two cases as equivalent from a cost perspective, which is not reflective of the resources used. Depending on how an organization implements its RVU approach, it also may not separate supplies or administered drugs from the procedure itself, offering a less-than-complete financial picture of the event.

"While addressing variation is probably the best method for curbing costs, RCC and RVUs don't work well here either," says Ismail. "RCC would only show variation when charges are different between patients, and RVUs only highlight variation when there is a difference in the procedures that were performed, which is not especially meaningful.

"You can't use either of these strategies to pinpoint areas to standardize and drive down utilization of services where they're not medically justified."

Hip Replacement Cost Comparison

Patient 1 - Hip Replacemenet

	Patient 1				
	RCC		ABC		
	$	Ratio	$	Activity Driver	$ Difference
Imaging - CT	200	CT Charge	157	Time on Machine	(43)
OR	6,750	Room Charge	7,482	Time in Suite and Acquisition Cost	732
Anesthesia	1,040	Service Charge	697	Time Under Anesthesia	(343)
PACU	900	Room Charge	878	Time in Room	(23)
Med-Surg	6,000	Room Charge	7,729	Time in Room	1,729
ICU	4,000	Room Charge	3,756	Time in Room	(244)
Pharmacy	360	Drug Charges w/Markdown	919	Acquisition Cost and Route of Admin	559
PT/OT	600	Service Charge	538	Time of Services	(62)
Woundcare	0	N/A	18	Time of Services	18
Other Clinical	0	N/A	106	Assorted	106
	19,850		**22,279**		**2,429**

Activity-Based Costing

Unlike ratio of costs to charges and relative value units, activity-based costing (ABC) captures every step along the patient journey to gain an accurate and comprehensive picture of resource consumption. This methodology looks at clinical, financial, and operational information to capture costs at the individual patient encounter level for all activity, regardless of whether it occurs in the inpatient or outpatient setting.

"ABC allows you to analyze groups of patients who have a certain medical condition, such as hip replacement, and see how their journeys differ in terms of costs and resource consumption," says Ismail. "This lets you quantify true costs of care for the medical condition, which can help if you are entering into a value-based arrangement for that condition.

"Not only can the data inform payment rates, it can highlight areas where you can minimize variation, ensuring the patient is treated in the most appropriate setting, with more cost predictability and consistency in quality."

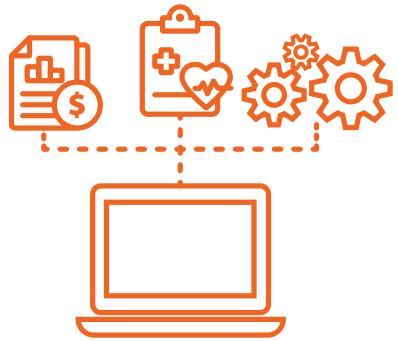
An Effective Approach

To fully capture the story of an individual patient journey, a solid ABC methodology must extract and combine data from many systems:

- Financial, such as payroll and general ledger
- Clinical, including EHR/EMR, formulary and OR files
- Operational systems, such as ERP, ADT and bed management

"Historically, these data sources have not spoken to each other because they were designed to serve different purposes and meet the needs of different stakeholders in a hospital system," Ismail says.

Within these categories, there is a range of data sources to integrate. For example, the general ledger is the most important financial system to include, but organizations also should make sure they review payroll, asset ledgers, FTE counts, and so on. On the clinical side, accessing the electronic medical record (EMR) is critical because it houses information regarding what happened to the patient from various clinical perspectives. The admission, discharge, transfer (ADT) feed tracks where the patient is located in the hospital at any given time, and tools like the bed management system indicates the resources being used to turn over patient rooms and transport patients.



Medical records show diagnosis and procedure codes for different patient types, allowing an organization to determine the severity of illness and which patient attributes impact care.

"There are many department-specific systems throughout a hospital utilized for patient management, and these can be helpful to include in an ABC analysis," Ismail says. "For instance, radiology, cath lab, and endoscopy systems are important to review."

Operationally, it's also wise to include supply chain and medication management systems because they track resource utilization. Note that an ABC approach should be based on true acquisition costs — especially for supplies and drugs, since these can be anywhere between 25% and 40% of a hospital's total operating expenses.

"While organizations can pursue ABC costing on their own, it can be a resource-intensive and time consuming proposition," says Ismail. "Plus, you may have to prioritize which areas of operations you want to measure because you may not have the resources to take a more holistic view.

"For instance, you may choose to examine your orthopedic or neuro populations for opportunities to reduce variation. But what if it's your OBGYN population or your general internal medicine population that's really driving the financial challenges you're trying to address?

"You don't know what you don't know, and you could miss opportunities unless you are using an automated system that employs a repeatable and systematic approach to analyze the organization as a whole."

Systemwide Decision Making

Regardless of whether an organization is pursuing a value-based strategy or just trying to better manage expenses, activity-based costing can provide clear, reliable insight into the costs to deliver care and identify variability.

Because the data is connected directly to operations and clinical indications, and validated for accuracy, the decision makers and front-line providers can trust the insights. Activity-based costing improves the accuracy of cost data and allows for more meaningful conversations with physicians, administrators, and other stakeholders.

"When you present decision-makers with information that is relevant to them, you are more likely to get their attention and affect change," Ismail says. "When all parties trust that the information is accurate because it's based on a complete analysis of the patient journey throughout the care continuum, you can be assured that any data-driven changes will have a positive impact on the organization's ability to deliver high-quality care at the lowest possible cost."

About Craneware

Founded in May 1999, Craneware has spent more than 20 years as the leading provider of revenue integrity solutions improving financial performance in U.S. hospital and health systems. In July 2021, Craneware announced the acquisition of Sentry Data Systems and Agilum Healthcare — optimizing an already-robust catalog of solutions with industry-leading 340B solutions and expertise.

As ***The Craneware Group***, Craneware, Sentry Data Systems, and Agilum collaborate with U.S. healthcare providers to plan, execute, and monitor operational and financial performance, so they can continue to deliver quality care and services to their communities. The Craneware Group's Trisus platform combines revenue integrity, cost management, 340B, and decision enablement into a single, SaaS-based platform, connecting actionable insights to deliver sustainable margin and operational efficiency — something no other single partner can provide.

For more information, please visit www.thecranewaregroup.com or follow @Craneware on Twitter and LinkedIn.

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