

RFHHA MANAGEMENT TIP OF THE DAY FOR HOSPITAL ADMINISTRATORS 1304

What is Activity-Based Costing in healthcare Part 2?

The hospital's goal is to deliver high quality care at low cost; and that's where Activity Based Costing helps in getting the visibility into the costs. This article is based on a simplistic approach to show how Activity Based Costing (ABC) can be used to arrive at the cost to serve a patient. The same concept can be extrapolated for cost of a service line such as Emergency Department, Geriatric outpatients and Neurology acute. This is similar to line of business P&L in other service organizations such as Banks. When the organization matures with ABM, the next step is to get into activity based budgeting/forecasting.

Overview of Costing

In an hospital, you would have Revenue centers and Support centers. Profit/Revenue center brings in revenue for the hospital where as support center enables the profit center to bring in the revenue. For instance, Human resources department, a support center does not serve the patient directly; however without that department you will not be able to recruit and sustain the workforce required for the patient care. Hence, you need to distribute the cost of having an HR department to profit centers and cost centers, such that the accurate cost of the center is reflected.

Cost Center

Profit Center

(Service Provider)

(Service User)

Billing	Operating Room
Information Technology	Blood Bank
House Keeping	Laboratory
Social Services	Pharmacy

Why do we need to allocate costs?

Allocating costs helps in –

1. Accurate costing of an profit/cost center
2. Improving resource utilization
3. Rationing limited resources

The intent of ABC in the hospitals is to understand and streamline the activities; the gist is to either reduce the cost of activities or streamline the activities. This in turn results in the reduction in cost to serve the patient. In addition, since you 'un-bundle' your costs, the data will enable

you in greater understanding of the activities and resource usage. Remember you have limited resources and optimum use of them would certainly help in keeping the costs lower.

One of the changes that will slowly start occurring during/after ABC implementation is the change in data capture pattern – potentially your forms will start capturing additional information about an event. For instance, in an imaging request form, you might ask if the request is for teaching purpose/research & development or patient care. This will help in demarcating the radiology costs associated with teaching and patient care; in other words it's un-bundling of costs.

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