

RFHHA MANAGEMENT TIP OF THE DAY FOR HOSPITAL ADMINISTRATORS 1307

What is Activity-Based Costing in healthcare Part 5?

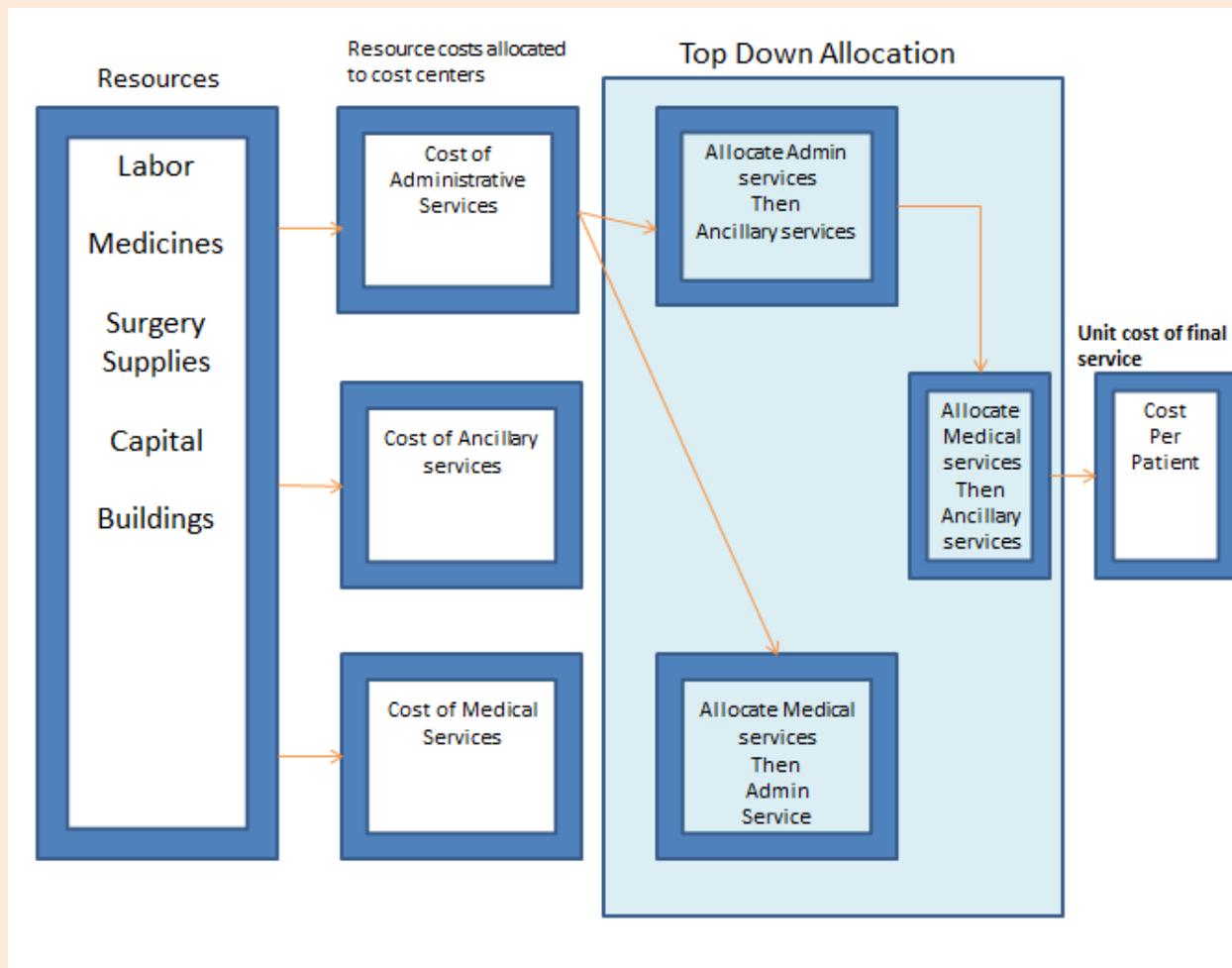
Step 6: Compute the indirect costs allocated to a patient:

A) **The activity rates that are computed in above step will be used to assign overhead costs to a cost object.** Assume that a patient consumes 90 minutes for Diagnostics, ½ day for surgery, 3 days for patient care after surgery. So the total indirect costs allocated to one patient would be as follows:

Activity pools (A)	Quantity of cost drivers * (B)	Rate per unit of cost driver (C)	Allocated cost (₹) (B X C)
Patient admission	1 Patient	₹2/ patient	2.00
Diagnostics	1.5 Hr.	₹41/ Hour	61.50
Surgery	½ patient-days	₹700/ patient-days	350.00
Patient care after the surgery	3 patient-days	₹20/patient-days	60.00
Patients check in and discharge	1 Patient	₹50/ patient	50.00
Total			₹473.50

B) **Another way of allocating overhead costs is by taking Manager/Subject Matter Experts (SME) Estimates (in percentages)** who have firsthand knowledge of the activities and allocate them to activity cost pools. These estimates are obtained by interviews and may change over a period of time. For instance the salaries (overhead) for 4 contract nurse practitioners are ₹200,000 per year. This data can be sourced from your sourcing and procurement system. Manager estimates for these four nurses are 10% in front office and 90% in diagnostic activities – what that means is they work in front office for 10% of the time and rest of the time they assist in the diagnostic activities. Your first stage allocation would result in ₹20,000 being allocated to front office and rest being allocated to diagnostic cost pool.

C) **Step Down method** is used to allocate costs from some service departments to other service departments. For instance allocating Information Technology costs to Billing if they have implemented a new system or upgraded the current system. We will discuss this methodology in greater detail in next management tip. The following shows the schematic of allocating Ancillary services/ Admin/Medical service costs using step down methodology.



Step 7: Compute the total cost per patient: Sum up Direct expenses and allocated indirect to arrive at total cost per patient as follows:

Direct expense per patient

Cost of medicines (from step 2) ₹ 100

Fees for Surgeon/consultant (from step 2) ₹ 500

Total direct costs ₹ 600

Allocated indirect costs per patient (step 6) ₹ 473.50

Total cost per patient (Emergency Surgery) ₹ 973.50

The above example shows the simplistic version of allocating costs and arriving at the total cost per patient. Similarly, you will be able to do departmental costing or service line costing. In the next few articles we will cover the service line costing and advanced costing concepts

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