



## BRIEFING NOTE #5

### COSTING OF HOSPITAL SERVICES

SEPTEMBER 21, 2013

**PURPOSE:** Costing of Hospital Services is an important component of funding and managing hospitals. This short note illustrates how it may be most useful.

**BACKGROUND:**

There are several purposes for which hospital service costing could be used. Three of these include:

- For funding hospitals
- For putting a value to a defined package of services
- For internal hospital management.

**Funding Hospitals**

In some countries, hospitals are, or have been, funded based on the number of services of each type that they perform and the cost of each service type. This could be described as a fee for service or a case payment method of funding. Case payment is when services for treatment of the same diagnosis are grouped together. The main difficulty with such an approach is that hospitals tend to generate more services whenever they are funded on this basis. In this way they can increase their revenue. This creates a problem for the funding agency and government in that costs quickly exceed the available budget.

The solutions to this over expenditure are undesirable. The government could increase the hospital funding levels requiring additional revenues or borrowing. This obviously puts pressure on other government spending which could have higher priority. A second solution is to pro-rate the payment of hospital costs. For example, hospitals could be funded based on 90% or 80% of the cost per service in spite of earlier agreements to pay the full amount. This generates even higher volumes and leads hospitals to reduce quality of service in order to cope with lower than expected revenue.

**Putting value to a defined package of services**

Some hospital insurance organizations like to put values on the services they provide. This is particularly useful if they are insuring some services and not others or when they are insuring some portions of the population and not others. This purpose is less useful when hospitals are funded to provide services they are equipped or qualified to provide for all the population.

**For internal hospital management**

Hospital managers seeking efficient and effective performance are constantly faced with the need to allocate or reallocate resources in order to meet the needs of their patients and to ensure high quality of care. It is difficult for them to make these reallocation decisions without knowing what costs they have. It is also useful for hospitals to compare their performance to other similar hospitals in order to determine if they are performing well or have room for improvement.

Similarly, the HII will want to be able to compare the cost performance of each hospital in relation to others so they can assist in encouraging better value. In addition, if in future hospital funding is to be based on a DRG or Case Mix basis, accurate costing is required as a part of that system.

### **There are several ways to determine the cost of hospital services.**

In the past few years, the HII has created a costing software system that collects costs in hospitals based on the allocation of actual costs, both direct and indirect to departments of the hospital. These costs are then divided by the number of services generated in each department resulting in a cost per service. The introduction of this system has been very useful in making hospitals aware of their costs, and creating a system to collect and aggregate costs. It has also resulted in training of several people in each hospital.

This system has several problems which make the results not useful for most purposes. These are related to the way the Ministry of Health has allocated staff within the hospitals and the use of prices they have instructed hospitals to use.

There is also a top down calculation of cost of hospital services which is being introduced at the three Pilot Hospitals in the EEHR Program. This will assist in improving the determining the cost of services.

### **ANALYSIS**

Costing of hospital services is most useful for purposes of internal hospital management and for management of the HII in assessing the performance of the hospitals. The EEHR program makes several recommendations for improving the costing methodology.

It is recommended that the cost of services not be used directly in the funding of hospitals but rather the costs be used to compare between hospitals and to enable hospital managers to make internal allocation decisions. This will be facilitated by continued improvement in the accuracy of data collected and submitted by hospitals. This accuracy improvement could be enhanced by adopting a Chart of Statistics and a Chart of Accounts. These are more detailed definitions of the services, service components and costs so that each hospital is consistent in their reporting.

Improving the accuracy of data submitted from hospitals also requires hospital staff training to be continued and for more auditing of submissions and hospital cost collection.

### **RECOMMENDATIONS:**

It is recommended that:

- The EEHR project to generate top-down costing be completed and the results used to assist the HII in comparing hospitals and that hospitals be given this information to enable them to make better internal decisions.
- The HII should continue to improve the accuracy and range of information collected and reported from hospitals.
- The HII should move to ICD 10 for diagnosis reporting. Most countries have adopted ICD 10 and in future, international comparisons of hospital performance will be useful.
- The HII should introduce a Chart of Statistics and a Chart of Accounts to define more clearly and consistently for hospitals what is included in each cost calculation.
- The HII should continue with training of hospital staff and more auditing and review of data submissions from hospitals to improve data collection procedures at hospitals.
- The HII should collect, analyze and distribute hospital performance and costing information to hospitals so they may compare themselves to their peer groups.