VERMONT ASSOCIATION OF
HOSPITALS AND HEALTH SYSTEMS

MEMORANDUM

TO: SENATE COMMITTEE ON HEALTH AND WELFARE

FROM: JILL MAZZA OLSON, MPA, FACHE
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VP OF POLICY & LEGISLATIVE AFFAIRS

SUBJECT: COST ACCOUNTING (S.244)

DATE: MARCH 8, 2016

This memo is in response to your request that VAHHS outline the strategies that hospitals use to identify and reduce expenses to help with your deliberations on S.244, which would require all hospitals to implement what are known as "cost accounting" systems.

Vermont hospitals are committed to reducing health care costs. However, we are concerned that S.244 would, in practical terms, require all hospitals to purchase software and hire specialized staff, without a clear benefit.

The current state and federal policy/regulatory environment creates strong incentives for Vermont hospitals to manage their expenses. The hospital budget process places limits on hospital revenues. Federal reimbursement models for larger hospitals (which are mirrored by Medicaid and commercial payers) use fee schedules that pay the same rate for patients within the same "diagnostic related group" (DRG), regardless of the expense to the hospital. As Medicare and other payers move away from fee-for-service payments, the incentive to focus on costs becomes that much greater. In that context, we do not believe a legislative mandate to purchase and implement a specific type of internal tool makes sense.

Background

- Cost accounting is a process that uses specialized software and dedicated staff to estimate hospital expenses down to the procedure level.

- Cost accounting considers all elements of patient care (staff, facility, equipment, supplies) and attempts to allocate some value for all those elements to each procedure. For example, a hospital might look at a procedure like setting a broken arm and try to assign the cost of the exam room, physician, nurses, cleaning staff, supplies and other expenses to the procedure.

- While other issues like price transparency and payment variation are important, they are separate and distinct from cost accounting, which is the subject of S.244.

- Cost accounting is a tool that may be useful in high volume, tertiary care hospitals that perform a complex array of services at high volumes – like the University of Vermont Medical Center, which has a robust cost accounting system in place already. The University of Utah Health Care recently garnered extensive media attention for their cost accounting efforts.

- Cost accounting may produce inconsistent results if volumes for a service are low or fluctuate. It also has little relevance when a service is at a minimum staffing level to keep it open and available, such as a small hospital emergency department.

- By itself, cost accounting is an expense. Our members estimate that the price of software even a very small hospital varies by the product, with a range of $50 thousand to $250 thousand for the initial investment, plus an additional 20% of the purchase prices for annual support. At a minimum, even our smallest hospitals would need to hire two FTEs, one with cost accounting expertise, to implement and maintain a cost accounting program.

Cost Identification and Management in Hospitals

Hospitals are organizations with many fixed costs – expenses that have little relationship to the number of patients who are served. They must maintain minimum staffing levels for services like the emergency department, even if the volume of patients is low. They must purchase and maintain medical equipment, the price of which is also unrelated to volume.

In general terms, hospitals have the following options to reduce costs:

- Remove unnecessary variation between physicians on resource use (supplies, lab tests, implants etc.)
- Reduce or eliminate services
- Re-negotiate contracts with suppliers and other contractors
- Reduce utilization

All Vermont hospitals use a variety of tools to identify and contain costs. Examples of tools that are in use in Vermont hospitals at present include:

- Staffing analysis tools that allow hospitals to review their staffing plans against external benchmarks.
- Financial and performance metrics that allow hospitals to compare their performance against regional and national data bases from many hundreds of hospitals and physician practices.
- Evaluation of variations in resource use between physicians performing the same procedures.
- External firms that specialize in cost analysis, including staffing levels and standardizing supply costs across physicians
- Group purchasing to leverage better prices with external vendors.
- Affiliations and collaborations between hospitals, which span a broad spectrum. Examples include telemedicine initiatives, contracts between smaller hospitals and larger hospitals for specialty services under which one hospital develops the service, but it can be offered in other communities to improve access and affiliations that include shared governance.

Relevant Future Trends

Vermont's Accountable Care Organizations are meant to assist health care providers in their efforts to provide high quality care as efficiently as possible. They are developing tools that help all hospitals evaluate their own performance, reducing the need for each hospital to develop those tools internally. All Vermont hospitals belong to an Accountable Care Organization.

The University of Vermont Health Network is expanding its cost accounting program to smaller hospitals in its network. As this rolls out, it will provide a good opportunity for Vermont hospitals to examine the impact of such programs in smaller facilities.