

Long-term Care Cost Accounting: Simple is Often Better

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by Allan B. Larson, CPA

"Cost accounting" has always been an ominous term within long-term care circles-but it doesn't have to be. Many different approaches and uses for cost accounting exist, and in many cases the process is easily integrated into monthly financial reporting.

This article will define cost accounting, describe the resulting information that is critical to management, discuss the importance of cost accounting in the world of the Medicare prospective payment system (PPS), and describe why it is important for managers in all departments of a facility to be cognizant of financial performance.

What's the Cost? It Depends

Cost accounting is simply a method or process of determining how much a specific unit of service costs. In long-term care, that unit of services is generally a resident day. In effect, under the old cost-reimbursed Medicare system (some Medicaid programs continue to be cost reimbursed), cost finding was a method of cost accounting that determined a facility's reimbursement per resident day, subject to certain limitations.

In determining the cost of a day of service in a facility, it is important to recognize that there are always fixed and variable costs. **Fixed costs** include departments within a facility that generally do not fluctuate with occupancy such as administrative, housekeeping, laundry, and plant operations. **Variable costs** will change depending on census and level of service, such as per diem ancillary contracts, medical supplies, nursing, and dietary services.

When you begin your process, identify fixed costs versus variable costs. Depending on how a facility is operated, one facility may consider a certain cost fixed while another facility considers it variable.

The key is to then take each cost and identify an appropriate allocation method. A facility should begin by directly identifying as many costs as possible. All other costs will be allocated by methods such as resident days, square footage, meals served, and pounds of laundry. These allocations can be done with a simple spreadsheet application or using certain healthcare-specific software. When determining the allocation methods, use logic and try not to make it complicated. A simplified approach that everyone understands will be more effective.

If a facility has different units providing varying levels of care, cost per resident day should be determined separately for each area (e.g., an acute care unit, a dementia unit, and a geriatric unit). In these cases, blending all costs across a facility would distort unit costs.

This cost of care information should be used extensively by management for a variety of purposes, including setting appropriate room rates, measuring profitability, and negotiating managed care contracts.

Better Information, Better Performance

The advent of the PPS has shifted Medicare reimbursement from a price-based system to a prospective payment system. This means that Medicare pays an all-inclusive rate based on clinical and other level of care factors. Under this system, it is critical to compile unit costs and compare them to the reimbursement rate, thus measuring performance under the Medicare system. Many managed care contracts are reimbursed in a similar fashion.

Determining accurate unit costs can also help a facility benchmark costs and set budget. All departmental managers should participate in this process. By comparing cost accounting data by department to industry averages, similar facilities, and past performance, management can quickly identify variances and make appropriate and timely decisions.

In the current long-term care environment, cost accounting has taken on a greater significance for both clinical and HIM professionals.

Financial managers must understand the impact of decisions that are made in care and documentation at the clinical level. At the same time, clinical and HIM personnel need meaningful cost data to effectively assist in managing costs under these payment rates. In many cases, the statistical data produced by HIM professionals have a direct effect on the costing of services.

Remember, cost accounting methods don't have to be complicated to be effective. Facilities should involve and inform personnel at all levels and in all departments. An understandable system that provides personnel with meaningful data will reap the best results.

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