

## Hospital Costs & ???

DHS Policy Advisory Panel  
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## Discussion Objectives

- What are the building blocks of hospitals costs, charges, ratios?
- What factors affect how hospitals set rates?
- How does hospital cost-charge ratio information flow into the actuarial and contract negotiation processes?
- Are there opportunities for improving the process or better achieving OHP goals.

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## Dave Witter, Witter & Associates

- OHSU – 17 years
  - Hospital CFO, COO, CEO
  - Interim University President
  - VP Finance & Administration
- Academic Medical Center Consortium - 6 years
  - President & CEO; 15 premier AMCs
  - CEOs & HSRs – quality-driven projects improving operations
- Association of American Medical Colleges – 6 years
  - Director Clinical-Administrative Data Service
  - CIO, chief business development officer
- Witter & Associates – last 4 years
  - Healthcare: evaluation, quality, policy, biz development, HIT/HIE planning, financial analysis, organization development
  - Clients: Quality Corp, OHPR, OAHHS, OCHIN, Regence ...

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## Disclaimers

- Long-time since involved in details of hospital finance, contracting & reimbursement
  - Fundamentals mostly the same
  - Rules, regs, reimbursement calculations **substantially** more complex
  - Fin mgmt tools much more sophisticated
- OHP started & evolved
- Just an observer, no axe to grind

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## Pie Questions – What the objective?

Getting to a Larger Pie ?

Slicing the Pie Differently?



OR - Better use the pie to serve more pieces?

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## Magical Boxes

- Magic Tricks & Black Box Processes:
  - Magicians: perform fancy routines
  - Audience: appreciates the performance but wonder how it works
  - Other magicians: may or may not be able to figure it out
- Healthcare has lots of magic/black boxes
- Nobody understands all the tricks

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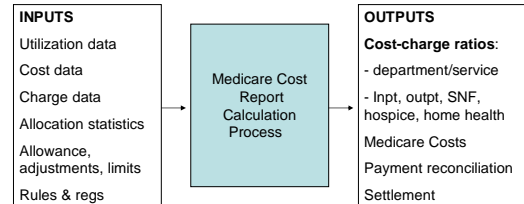
## Multiple Magic Boxes

- Hospital costs, charges, ratios
- Hospital finances, rate setting
- Actuarial estimates of OHP costs
- OHP scope funding, services, rates
- FCHP contracting with providers

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## Magic Box: Hospital Cost Report



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## Hospital Costs

- **Multiple definitions of “cost”**
  - Hospital financial statements (GAAP definition)
  - Allowable cost for Medicare purposes
- **Levels of costs**
  - Enterprise as a whole
  - Departments – cost centers
  - Programs – product lines

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## Costs by Department

- Patient service delivery departments  
inpatient units, ICUs, labs, rads, dx units, therapy services, ED, OR, clinics, SNF, home health, etc (revenue centers)
- Overhead cost centers: new/old capital depreciation, general admin, O&M of facilities, housekeeping, dietary, nursing admin, central supply, med records ....
- Medicare cost report step-down process

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## Cost Allocation Process

- Medicare cost report step-down process
- Trial balance from accounting records
  - Adjustments, reclassifications, additions, deletions
  - = Net Expenses for Costs Allocation
  - Prescribed sequence for assigning overhead costs to revenue producing centers – The Step Down Process
  - = Allocated Costs by Revenue Centers

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## Cost – Charge Ratios

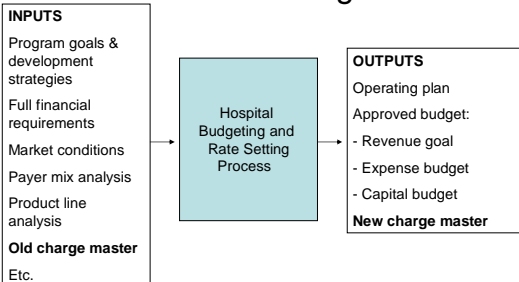
- Allocated Costs by Revenue Centers
- Limitations & disallowances
- = Adjusted Allocated Costs by Center
- Total Charges by Revenue Center / Adjusted Allocated Costs by Center
- = Cost to Charges Ratio for each Center

THE KEY BUILDING BLOCK

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## Magic Box: Hospital Budgeting & Rate Setting



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## Full Financial Requirements

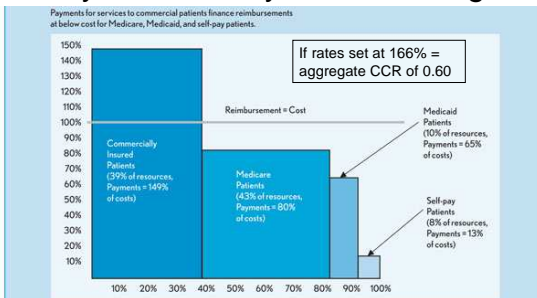
- Operating costs of patient/other services
- Un/under compensated care
- Capital & program developments financed from operations
- Debt service on borrowed funds
- Changes in working capital (A/R, cash flow, inventory)
- Operating margin target:

**NO MARGIN, NO MISSION**

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## Payment Reality: Cost Shifting

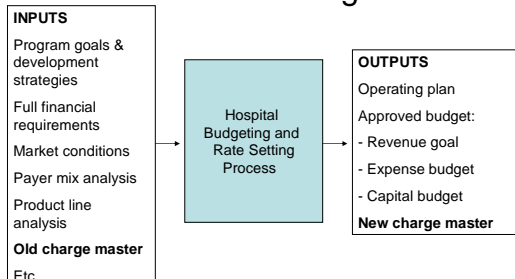


Source: Moore KD, Coddington DC. Healthcare reform initiatives – the new wave. Healthcare Financial Management, July 2007, 74-81. [http://www.hfma.org/hfm/2007archives/month07/feature\\_moore.htm](http://www.hfma.org/hfm/2007archives/month07/feature_moore.htm)

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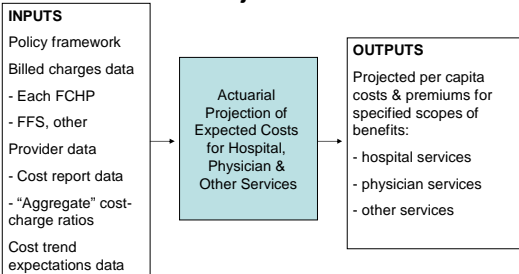
## Magic Box: Hospital Budgeting & Rate Setting



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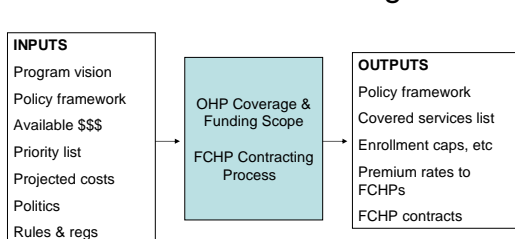
## Magic Box: Actuarial Cost Projection



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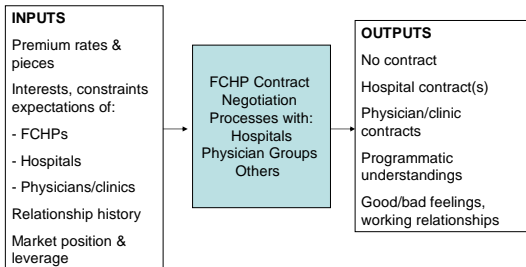
## Magic Box: OHP Funding & FCHP Contracting



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## Magic Box: FCHP Contracting with Hospitals & Physicians



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## FCHP & Hospital Contracting Issues

- Different perspectives of what's reasonable payment/rate
- Different approaches to thinking about finances
- To most hospitals, an FCHP is just another health plan; why treat differently?
- HB3501 & other legislative impacts
- Other OHP/FCHP changes

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## Better Use of OHP Services

Can incentives or other changes in these magic boxes encourage better outcomes &/or lower costs?

- Shift inappropriate ED use to physician offices?
- Unnecessary hospital admits or readmits?
- Reduce avoidable lab & other tests?

Doubtful, But there are other ways/things

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## Other Policy Observations

- Self-evident: limited funding, enrollment & covered services limitations are tough on clients and all the players
- Lots of opportunities for better transparency (actuarial calculation process, FCHP performance ?)
- Opportunity to shorten lags for cost report data into actuarial calculations
- Better aligning OHP incentives with outcomes & private sector initiatives

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