FEBRUARY 2007

healthcare financial management

hfm

healthcare financial management association www.hfma.org

Steven H. Berger

treating technology as a luxury? 10 necessary tools

If you've been thinking that technology for improving healthcare financial management is a luxury, think again.

Tools. Everyone wants tools—to perform a job better, produce a better result, or achieve a better outcome. And healthcare organizations seem to want tools that are beyond the capabilities of most hospital legacy financial systems.

But are hospitals actually acquiring and using the technology that allows them to achieve significantly better financial outcomes? There are techniques and software that every hospital—regardless of size, location, tax status, or payer mix—should acquire and use. And this technology is commercially available today; it is not science fiction.

10 WAYS TO IMPROVE HEALTHCARE COST MANAGEMENT

- Enforce accountability.
- Monitor goals in a timely manner.
- Report results using a balanced scorecard technique.
- Establish a goal of overhead costs as a percentage of total costs.
- Adopt flexible budgeting.
- Adopt benchmarking.
- Develop percentile goals.
- Determine labor ratio goals.
- Reduce resource consumption.
- Purchase and use effective cost-management tools.

The August 2004 issue of *hfm* included an article I wrote describing 10 ways to improve healthcare cost management. Unfortunately, based on unscientific surveys I have conducted during my continuing education classes since that time, it is clear that many of the more than 5,000 U.S. hospitals still have not adopted all the technology and techniques discussed in that article.

It is past time that hospitals recognize that these tools and techniques are not a luxury—they are a necessity. Hospitals that do not have these in their management toolkits are missing out on the opportunity to go well beyond their current results. Much of this technology has been available for years, and its usefulness has been validated. Each technique and piece of technology is inherently valuable for different reasons, making them necessary items in every healthcare organization's toolkit. And although there is a financial cost to most of these tools, the benefits—listed in this article—far outweigh the costs. Healthcare organizations should not let the costs deter them from acquiring the value inherent in these effective tools.

TOOL Daily Dashboard: Keeps Eyes on the Prize

The dashboard is essentially the repository of all the information collected by other tools. It places the organization's goals and results in context, in a timely manner, in an understandable and readable format, to enable the organization's leaders to take action.

The dashboard allows the organization to determine its most important needs and set goals so that the outcomes can be effectively monitored for results. Among the dashboard's benefits are that it places these metrics directly in front of decision makers on a daily basis in a usable format. New technology and commercial software tools allow the organization to adopt dashboards for improved outcomes.

Effective daily dashboard reporting systems allow healthcare organizations to:

- Improve the understanding of operational results through a series of pictures, tables, or graphs
- Identify the variances between approved goals and actual results for volumes, revenues, hours worked, and productivity

> Clarify the critical success factors that need to be met
> Take appropriate action

TOOL Balanced Scorecard: Tracks the Indicators

While the daily dashboard is designed to provide instant information to the hospital's decision makers, the balanced scorecard uses the same or similar indicators but typically on a longer time line, such as monthly or quarterly. Both are developed to help the organization's leaders take appropriate action based on results.The scorecard concept has been developed to allow the user to see, at a glance, the goals and outcomes of those indicators considered most important by the organization's leaders. These indicators are most commonly arrayed around aggregate dimensions of service. For example, several U.S. hospitals use the four-quadrant balanced scorecard approach developed by two Harvard professors, Robert Kaplan and David Norton, in their first book, *The Balanced Scorecard*. Other hospitals have developed their indicators around the "five pillars" approach of Quint Studer in his book *Hardwiring Excellence*. And other hospitals have simply developed their own grouping of indicators for analytic purposes.

One of the most important enhancements to the scorecard approach is the ability to drill down from the organization level to the division and department levels so that the entire organization is operating toward the same goals. There are many software tools on the market that enable hospitals and healthcare systems to automate the inputs and outputs, making the reporting clean, quick, and timely.

TWO TYPES OF BENCHMARK DIMENSIONS

The Four Quadrants	The Five Pillars
Financial	Financial
Customer satisfaction	Service
Internal process	Quality
Learning and growth	People
	Growth

According to Kaplan and Norton, effective balanced scorecards enable organizations to:

> Clarify and gain consensus about strategy
> Link strategic objectives to long-term targets and annual budgets
> Communicate strategy throughout the organization
> Align department and personal goals with organizational strategy
> Perform periodic and systematic strategic reviews
> Obtain feedback to learn about and improve strategy
> Take appropriate action

TOOL Benchmarking: Points the Way(s) to Improvement

The best way to develop goals within scorecard indicators is through peer group benchmarks, a technique that has been successful in several industries. Manufacturing companies, for example, have made improvements in several scorecard dimensions by setting higher goals than originally thought possible because they learned that competitor firms were, in fact, doing better—possibly a lot better.

In its simplest form, benchmarking allows organizations to set their own goals around an appropriate percentile. For some organizations, that may mean the 50th percentile, or median. For other organizations and specific indicators, the appropriate percentile may be the 75th, 90th, or even 99th. Benchmarking information—whether financial, satisfaction, quality, people, or growth—is generally available from several reputable companies throughout the industry.

Effective benchmarking analysis allows healthcare organizations to:

> Develop more reasonable budget forecasting through the evaluation of variances for revenue opportunities, cost performance, and FTE utilization
> Identify inefficiencies and prioritize opportunities with the greatest operational impacts at organization and department levels
> Report in ways that allow the organization's leaders to make better decisions based on representative and appropriate comparative information
> Take appropriate action

Benchmarking can be coupled with automated software tools to create useful reports for decision makers. If these reports are used effectively, the organization can determine courses of action for better outcomes.

TOOL Flexible Budgeting and Monitoring: Allows Revenue and Expense Planning

Flexible budgeting and monitoring technology allows organizations to plan their revenues and expenses specifically around volumes.

My informal class surveys support the conclusion that more than half of U.S. hospitals are not preparing or monitoring their budgets in a flexible, volume-adjusted manner. When asked for the reason, many healthcare CFOs say that they would like to do so but do not have the software.

Many of the budgeting systems provided by a general ledger software maker do not allow for flexible budgeting, so some hospitals have developed and are using rudimentary spreadsheet-based budgeting systems that do not have capabilities for flexing operating budgets. Flexible budgeting and monitoring software allows organizations to develop their goals at the account code level on a revenue-per-unit or cost-per-unit basis. Thus, when evaluating whether the flexible budgeting goals have been met, the software first multiplies the actual volumes by the per-unit revenues or costs and then compares this flex-budgeted outcome with the actual revenues or costs. The derived benefit is that volume is no longer a reason for any variance from goal; it has been factored out of the equation. This helps managers to better understand their departmental financial outcomes and the reasons for variances apart from volume. In addition, organizations experience the

It is past time that hospitals recognize that these tools and techniques are not a luxury—they are a necessity.

most powerful benefit of a flexible budgeting and monitoring software system when the software is able to instantly generate e-mail alerts whenever the actual results are outside parameters set by the organization. Only software with e-mail alert capabilities enables administrators to take immediate action to address out-of-compliance events.

Effective flexible budgeting and monitoring software systems allow organizations to:

> Set per-unit goals around volumes so that results can be more realistically monitored
> Help department managers understand that volumes have an impact on results
> Display the results with easy-to-use drill-down capabilities, allowing managers to clearly understand variances
> Send e-mail alerts to the department responsible for the out-of-compliance condition and to the department head and the finance division so that immediate and appropriate action can be taken to improve the situation

TOOL Labor Management Systems: Help Set Productivity Standards

Labor management is imperative for a well-run healthcare organization. Yet, according to my informal class surveys, only about 20 percent of healthcare organizations are effectively using any type of labor management technique or technology.

Labor management is a technique that sets a standard for labor productivity (hours per unit of service) and average labor rates. These labor standards can be internally derived or can be set using benchmarks. The standards can then be compared with the actual results, in a monitoring framework, to determine if the goals have been met. The results are generally monitored for productivity analysis (hours per unit of service—the efficiency variance) and average hourly rate analysis (the rate variance).The most effective way to use this information is to monitor it on a periodic and timely basis in a manner that enhances understanding and accountability. The goal is to help managers optimize the number of worked and paid hours in relation to the units of service produced and calculate the cost of those hours. Although more hospitals are claiming to use a labor management system, not all are reporting to their managers on a timely (daily or even shift-by-shift) basis. Reports are most effective when they can be used to make timely decisions. Thus, the most effective labor management system provides timely information in an effective reporting format.

Effective labor management software systems enable healthcare organizations to:

> Match the department's actual labor costs with its standard costs on a periodic basis
> Track performance by showing managers exactly how well labor is being managed in relation to organizational objectives
> Drill down to the personnel level so managers can understand the factors responsible for the variances, if any
> Take appropriate action

TOOL Nonlabor Management Analysis: Tracks Variances

Although labor takes up 50.5 percent of most hospitals' net revenues (according to Fitch Ratings, August 2006), the nonlabor component accounts for another 30 percent to 35 percent, not counting interest and depreciation. Healthcare organizations should have a software tool in place that allows them to easily understand the nonlabor numbers and any variances from the stipulated goals.

Managers should be able to quickly evaluate any variances through e-mail alerts and drill down to the source of the variance, whether caused by accounts payable invoices, journal entries, or inventory distribution. Although many hospital systems allow managers to electronically drill down to information, some systems require users to click through six or seven screens before getting to an answer. When a system is that difficult, it is neither effective nor efficient. Thus, hospitals need systems that allow department managers and finance staff to easily pull up information in a flexible and timely manner.

Any hospital without a functional contract management system is forfeiting real cash on underpaid claims.

Effective nonlabor management analysis software systems allow healthcare organizations to:

> Track actual expenses against the organization's flexible budget to determine compliance
> Easily drill down to the detail level for better understanding of utilization of resources
> Send e-mail alerts to the department responsible for the out-of-compliance condition and to the department head and finance division so that immediate and appropriate action can be taken to improve the situation

TOOL Service Line, Physician, and Patient-Level Reporting and Analysis: Provide Decision Support

Organization and departmental financial statements provide high-level information to users about overall outcomes. These are important and useful to certain stakeholders, such as the board of directors, executives, and investment managers, who need to understand the organization's financial health. Yet these high-level reports are simply an aggregation of the revenues and expenses being produced by and for patient services. It is therefore imperative for the organization to be able to understand the financial outcomes of its actions at the patient level so that this information can be aggregated back up at a physician, diagnosis-related group, ambulatory payment classification, or other level.

Hospitals should acquire and maintain a decision support reporting system that decision makers can use quickly and easily to understand the outcomes achieved within these categories. It is difficult to imagine effectively managing the organization without this information.

For example, if you were able to evaluate the profit or loss at a service line level, wouldn't you also want to be able to drill down further to the DRG, ICD-9, physician, and patient levels to understand which physicians were producing positive or negative margins? This is not an attempt to create economic credentialing, but to recognize any significant variability in practice patterns so that further analysis and education can be developed. This is one of the primary goals of decision support technology.

Effective service line reporting systems allow healthcare organizations to:

> Develop a baseline financial position for planning by analyzing volume, revenue, and cost information
> Evaluate net margin per case at the DRG level, by clinical category, for the service line as a whole and by institution
> Identify areas where operating competencies could be enhanced for better financial performance
> Take appropriate action

To effectively use this type of system, hospitals need two additional automated software tools that are linked (integrated or interfaced) to the patient-level decision support software system—cost accounting and contract management.

TOOL Cost Accounting Technology: Shows Costs of Patient Services

Microbased cost accounting is used to assign direct or indirect and variable or fixed costs to each element of charge or procedure codes within the chargemaster. These elements can then be rolled up or aggregated to determine the costs of inpatient or outpatient services at the DRG, APC, physician, and patient levels. This would appear to be advantageous to hospitals, as it gives them drill-down information needed to determine whether they are making or losing money at each level.

However, this technique, which generally requires software tools, remains controversial within health care. It appears that less than 30 percent of all hospitals have adopted cost accounting at the charge or procedure level. Reasons given by CFOs for not using microbased costing include:

> Insufficient time to develop the costing elements
> Insufficient money available in the budget to acquire the software
> Insufficient accuracy of costing elements for use in making informed decisions

Although there is no accuracy in microbased costing (the first time an assumption is made, "accuracy" no longer applies), it is a reasonable method for determining outcomes on which decisions can be based. Only with such costing can a healthcare organization reasonably know which services, product lines, physicians, or payers are positively or negatively contributing to its financial outcomes. This is simply a requirement of good general and financial management. It is a necessity, not a luxury.

Effective microbased costing systems enable healthcare organizations to:

> Develop, analyze, and manage the procedure-level cost of enterprisewide services through direct costing of labor and nonlabor elements and indirect costing with appropriate allocation of overhead expense based on step-down methodology
> Couple the costing system with a contract management system to develop and understand profitability by procedure, diagnosis, DRG, APC, payer, physician, and patient
> Take appropriate action

TOOL Contract Management Technology: Shows Expected Net Revenue

As long as a hospital has at least 10 percent of its net revenues coming from managed care payers, it is well worth the investment in time and money to acquire and deploy a contract management system. This technology provides hospitals with the ability to know, with certainty, the expected net revenue of every patient at discharge regardless of payer.

Although that is a hallmark of good management, apparently less than 30 percent of hospitals have adopted this technique. Instead, most hospitals are waiting around for the managed care companies to pay them before recording the cash receipt. This causes two substantial management problems:

> The hospital does not know, independently, whether every payment is correct (and they are not all correct).
> The delays in recording payment cause the financial statements to contain estimates rather than actual information (more accrual, less accuracy).

A contract management system is not a luxury item for hospitals; it is a necessity for good management. Any hospital without a functional contract management system is forfeiting real cash on underpaid claims. Based on experience, a contract management system can pay for itself in less than one year as long as there is commitment for its use. It is a must-have tool for effective financial management.

Effective contract management software systems enable organizations to:

> Coordinate all phases of contracted payer business (negotiations, payment compliance, performance review)
> Recover prior contract management under-payments by identifying payment variances
> Ensure proper payments on all subsequent claims as it accurately calculates expected reimbursement
> Model complex contracts with multiple reimbursement formulas in a simple and timely manner
> Take appropriate action

TOOL Denials Management Software: Helps Reduce Denials and Write-offs

Denials management has been a hot revenue cycle topic for the past several years. Although the median days of revenue in accounts receivable have declined over the past four years (from 63.1 days in 2002 to 50.5 days in 2006, according to Fitch Ratings), denials have continued to have a strong negative influence on hospital income statements.

According to research by denial management companies, nearly 20 percent of all claims are denied, and nearly 20 percent of denied claims are never resubmitted—resulting in millions of dollars in lost revenue for an average-sized hospital. And because of the complexity of the denials management process, revenue cycle personnel are unable to accurately report the true losses, often recording them as contractual adjustments rather than assigning them the proper denial classification.

Several steps are needed to solve the challenge of denied claims in a healthcare organization. A first step is to identify and understand the underlying causes of the denial so that the organization can track and control the denied claims, ultimately preventing the denial from occurring in the first place.

Effective denials management software systems allow organizations to:

> Identify sources of denials and improve analysis capabilities
> Standardize denial categorization
> Reduce the number of denials
> Automate workflow, thus increasing efficiency
> Allow individual and departmental productivity monitoring
> Reduce write-offs and increase revenue as well as the ability to collect
> Take appropriate action

Not a Luxury Item

These 10 tools and techniques provide a clear path for significant financial improvement for all U.S. hospitals. This technology is a necessity for efficient and effective operational management; without it, hospitals are giving up significant opportunities for better financial results. These tools provide healthcare organizations the best chance to meet their goals. ●

About the author

Steven H. Berger, FHFMA, CPA,
is president, Healthcare Insights, LLC, Libertyville, Ill., and a member of HFMA's First Illinois Chapter (sberger@hcillc.com).

Reprinted from the February 2007 issue of *Healthcare Financial Management.*
Copyright 2006 by Healthcare Financial Management Association, Two Westbrook Corporate Center, Suite 700, Westchester, IL 60154
For reprint information, call 1-800-252-HFMA