

## From the CFO's Desk - Costs Matter Developing a Unit Cost Model

*By Cindy Nyberg*

Developing a unit cost model using both financial accounting and practice management system data will provide partners and administrators with financial information that can contribute to making better informed business decisions. Successful businesses know the cost to manufacture or deliver their goods and services.

Before you begin developing the unit cost model, there are three important things to remember:

1. The ends must justify the means.
2. Updated data systems must also support the other uses for financial statements and data, such as physician's compensation calculation.
3. Build the model so it is flexible and can support multiple decision points. A unit cost model can be simple or sophisticated. The model should be updated at least annually and a best practice is to update quarterly or to support a specific decision. This can be calculated by CPT code, location, patient or a specific service.

**The calculation for the cost of an office visit is the following:**

**Total operating expenses to deliver the care**  
**Divided by**  
**Total units billed for the care**

The first step is to prepare your chart of accounts to capture the operating expenses into relevant and reportable general ledger accounts. I prefer using the following outline of "parent" accounts that summarizes additional subsidiary accounts:

- *Support Staff Compensation and Benefits*
- *Facilities*
- *Furniture and Equipment*
- *Medical Supplies*
- *Miscellaneous Expenses*
- *Midlevel Compensation and Benefits*
- *Physician Associates Compensation and Benefits*
- *Partner Compensation and Benefits*

Once your chart of accounts is updated, prepare a listing of all active general ledger expense accounts and provide a description of what types of expenses are charged to the accounts. This is a very important step that ensures that the data will be consistent and standardized, and so the staff will not have to guess where to record an expense.

Next, define your departments in your financial accounting system. I highly recommend taking the time to account for your expenses by department, including your administrative departments. At first, this may seem like an unnecessary use of time, but eventually there will be information necessary to make a decision that will require department costs. An example of this is determining the cost of engaging a billing company, compared to performing the billing in house.

A department follows the organization chart and can be defined by the services provided, or by location. There can be a primary department with subsidiary departments, and will be either a profit center, such as a pediatric office, or a cost center, such as billing. A cost center can either be a direct cost, such as nursing, or an indirect cost, such as administration. It is a best practice that departments in the general ledger should be the same as in the practice management system.

Accumulating accurate cost information by department is essential, and the first step in developing a unit cost model. This can be very detailed, such as charging all departments with rent based on the percent of total square feet occupied. Another example is charging health insurance costs to each department, based on their employees' costs. In my experience, both of these exercises are worth the initial effort. Once the worksheets are set up, it ends up being fairly efficient. On the other hand, I don't recommend counting paper clips and charging to departments. Ends must justify the means.

Next month, we will begin assembling the model by evaluating service contributions to a patient visit.