

Office of Statewide Health Planning and Development  
ACCOUNTING AND REPORTING MANUAL FOR CALIFORNIA HOSPITALS

**COST FINDING**

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**PREFACE**

**5001**

This chapter provides an overview of the cost finding process as well as the basis and sequence of the allocation. The chapter also addresses adjustments and reclassifications which are to be made.

**PRINCIPLES OF COST FINDING**

**5010**

Cost finding is the apportionment or allocation of the costs of the non revenue-producing centers to each other and to the revenue-producing centers on the basis of the statistical data that measure the amount of service rendered by each center to other centers. The purpose of cost finding is to determine the total or full costs of operating the revenue-producing centers of the hospitals.

The underlying principles governing development of the required sequence of allocations for cost finding include:

- 1) Cost centers that provide the greatest amount of service to the greatest number of other centers and receive the least from others are apportioned in the first stages of cost finding.
- 2) When the above determination could not be made, the allocation sequence was made based on the greatest amount of accumulated cost.

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**BASES AND SEQUENCE OF ALLOCATION**

**5020**

The process of cost finding to be used is called the step-down method. This method gives recognition to the fact that the services rendered by certain non-revenue - producing centers are utilized by other non-revenue - producing centers, as well as by the revenue - producing centers. The accumulated cost in a non-revenue - producing center, therefore, is allocated to other non-revenue - producing centers which utilize its services, as well as to the revenue - producing centers to which it renders services. Once the costs of a non-revenue - producing center have been allocated, however, that center is considered closed and will not receive any portion of the costs of the other non-revenue - producing centers whose costs have yet to be allocated. The required sequence of and statistical bases for allocating the costs of non-revenue - producing centers are as follows. The statistical bases are defined in Section 5032.

<u>Non-Revenue Producing Center</u>	<u>Statistical Basis for Cost Allocation</u>
Interest - Other	Square Feet
Insurance - Other	Square Feet
Licenses and Taxes (Other than on Income)	Square Feet
Depreciation and Amortization	Square Feet
Leases and Rentals	Square Feet
Interest - Working Capital	Accumulated Costs
Hospital Administration	Accumulated Costs
Governing Board Expense	Accumulated Costs
Public Relations	Accumulated Costs
Management Engineering	Accumulated Costs
Community Health Education	Accumulated Costs
Other Administrative Services	Accumulated Costs
General Accounting	Accumulated Costs
Communications	Accumulated Costs
Other Fiscal Services	Accumulated Costs
Printing and Duplicating	Accumulated Costs
Personnel	Hospital FTEs
Employee Health Services	Hospital FTEs
Employee Benefits - Non-Payroll Related	Hospital FTEs
Non-Patient Food Services	Hospital FTEs
Purchasing and Stores	Supplies
Housekeeping	Square Feet Serviced
Grounds	Square Feet
Security	Square Feet
Parking	Square Feet
Plant Operations	Square Feet
Plant Maintenance	Square Feet
Other General Services	Square Feet

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<u>Non-Revenue Producing Center</u>	<u>Statistical Basis for Cost Allocation</u>	
Dietary	Meals Served	
Laundry and Linen	Dry and Clean Pounds Processed	
Patient Accounting	Gross Patient Revenue	
Data Processing	Gross Patient Revenue	
Credit and Collection	Gross Patient Revenue	
Auxiliary Groups	Gross Patient Revenue	
Chaplaincy Services	Gross Patient Revenue	
Medical Library	Gross Patient Revenue	
Medical Records	Gross Patient Revenue	
Medical Staff Administration	Gross Patient Revenue	
Social Work Services	Gross Patient Revenue	
Utilization Management	Gross Patient Revenue	
Insurance - Hospital and Professional Malpractice	Gross Patient Revenue	
Admitting	Gross Patient Revenue	
Other Unassigned Costs	Gross Patient Revenue	
Outpatient Registration	Gross Outpatient Revenue	
Nursing Administration	Nursing FTEs	
Inservice Education - Nursing	Nursing FTEs	
Central Services and Supplies	Costed Requisitions and Cost of Sales	
Pharmacy (excluding Cost of Sales)	Costed Requisitions and Cost of Sales	
Research Projects and Administration	Gross Patient Revenue	
Education Administrative Office	Students in All Approved Programs	
Student Housing	Students in All Approved Programs	
Licensed Vocational Nursing Program	Assignment of Student Nurses	
School of Nursing	Assignment of Student Nurses	
Paramedical Education	Assignment of Paramedic Students	
Other Health Profession Education	Assignment of Paramedic Students	
Medical Postgraduate Education	Assignment of Medical Post-Graduate Students	
 <b><u>COMPILATION OF DATA</u></b>		<b>5030</b>
 <b>REVENUE AND EXPENSES</b>		<b>5031</b>

Revenue and expenses must be either accumulated in or reclassified to the accounts according to the functional units that produce and incur them.

**COST FINDING**

**STATISTICS**

**5032**

Cost finding utilizes statistics in making the distribution of indirect costs to revenue-producing cost centers. Adequate statistical data must be maintained to measure the performance of each center. Each non revenue-producing center shall have one statistic that measures its production (volume of service to other centers).

It is advisable to develop a written procedure for the collection of statistical data.

The definitions and sources of the required statistics for cost allocation are as follows:

Definitions and Sources of Statistics for Cost Allocation

<u>Statistic</u>	<u>Definition or Method of Computation</u>	<u>Source</u>
Square feet	The number of square feet in each cost center of the hospital must be determined either by a physical measurement of the hospital or by a measurement from blueprints. Floor area measurements must be taken from the center of walls to the center of adjoining corridors if a hallway services more than one cost center. Exclude stairwells, elevators, and other shafts. General and unused areas, hallways, waiting rooms, storage areas are also to be excluded. Hallways, waiting rooms, storage areas, etc., serving only one cost center must be included in that cost center. Common areas such as conference rooms, break rooms and other areas used by more than one cost center must be excluded. When changes in assigned area have been made during the year as a result of new construction, cost center relocation, expansion, or curtailment of service, statistical data must be maintained to allow for the development of "weighted" areas for the fractional part of the year. For example, the addition or deletion of 1,200 square feet for a six month period would be an adjustment of 600 square feet; where the same area serves more than one function, this area must be apportioned between or among the appropriate functions	Blueprints of the hospital facility or actual measurement if blueprints are not available.

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<u>Statistic</u>	<u>Definition or Method of Computation</u>	<u>Source</u>
Square Feet Serviced	The number of square feet serviced shall be computed in the same manner square feet are computed, however, include only square feet serviced on a regular and ongoing basis.	Blueprints of the hospital facility or actual measurement if blueprints are not available
Accumulated costs	The direct costs of each cost center and indirect costs previously allocated.	Report Page 20
Hospital full-time equivalents	Divide total productive hours (hour worked) by 2080.	Payroll accounting records (or Report Pages 21 and 22)
Supplies	Total direct costs contained in the natural classification "Supplies" by cost center, as reclassified.	General ledger, as reclassified (or Report Pages 17 and 18)
Meals served	Number of meals served shall include only regularly scheduled meals and exclude snacks and fruit juices served between regularly scheduled meals.	Actual count maintained by dietary
Number of dry and clean pounds processed	Statistic shall include the weight of linen processed for each cost center's use (including linen of personnel quarters and employee housing) for the entire report period.	Actual count maintained in the laundry and linen cost center.
Gross patient revenue	Gross patient revenue of each revenue-producing center	General ledger (on Report page 12)
Gross Outpatient Revenue	Gross outpatient revenue of each revenue producing center.	General ledger (on Report page 12)

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<u>Statistic</u>	<u>Definition or Method of Computation</u>	<u>Source</u>
Nursing full-time equivalents	Divide total productive hours for nursing employees by 2080.	Payroll accounting records (on Report page 21)
Costed requisitions for central services and supplies	Total dollar amounts of costed requisitions by an actual accumulation or on a sampling basis. (See instructions for completing Report page 19).	Copies of requisitions maintained in Central Services and Supplies cost center.
Costed requisitions for pharmacy	Total dollar amount of costed requisitions by an actual accumulation or on a sampling basis. (See instructions for completing Report Page 19.)	Copies of requisitions maintained in Pharmacy cost center.
Students on all approved programs	Number of students enrolled in all approved teaching programs during the reporting period by assigned Education Program.	Education records
Assignment of student nurses	Number of full-time equivalent (FTE) nursing students enrolled in LVN and student nursing programs by assigned cost center. FTE is defined as the number of paid student nurse months divided by 12. Partial months are counted as one when one-half or more of the month is worked and not counted when less than half of the month is worked.	Education records
Assignment of Paramedical students	Number of full-time equivalent students enrolled in paramedical and other health profession educational programs by assigned cost center. FTE is defined as the number of paid paramedical students months divided by 12. Partial months are counted as one when one half or more of the month is worked and not counted when less than half of the month is worked.	Education records

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<u>Statistic</u>	<u>Definition or Method of Computation</u>	<u>Source</u>
Assignment of residents and fellows.	Number of full-time equivalent (FTE) residents and fellows in approved and non-approved teaching programs by assigned cost centers. FTE is defined as the number of paid residents/fellowship months divided by 12. Partial months are counted as one when one half or more of the month is worked and not counted when less than half of the month is worked. Fellows are graduates of a school of medicine or osteopathy who have had a period of post doctoral medical education and are pursuing a more individualized course of advanced residents who have already completed the minimum number of years of training required for board eligibility.	Education Records



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**ADJUSTMENTS AND RECLASSIFICATIONS** **5040**

**OTHER OPERATING REVENUE** **5041**

Other operating revenues (Accounts 5010-5790) are reported on Report Page 14. Certain of these revenue are offset against the costs of the cost center generating the revenue on Report Page 20 during cost allocation. Revenues generated by several cost centers and minor cost recoveries are offset against direct costs prior to cost finding on Report Pages 17 and 18. Research and education revenues and restricted fund transfers are offset against costs after cost finding on Report Page 20.

**NON-OPERATING EXPENSES** **5042**

Non-operating expenses are included in the cost finding trial balance (Report Page 20) and will absorb overhead costs through step down, if appropriate. Direct non-operating expenses are not allocated to the revenue-producing cost centers, but are carried directly to the Income Statement (Report Page 8). Provision for income taxes and extraordinary items are not shown on the cost finding schedule but are carried directly to the Income Statement.

**RECLASSIFICATION OF COST CENTERS** **5043**

Reclassifications are necessary to adjust the hospital's records to the reporting requirements of the Office if they do not already reflect these requirements. Reclassification of physician and students' compensation is accomplished on Report Pages 15 and 16. All other expense reclassifications must be made on the hospital's books and records prior to entering the trial balance amounts on Report Pages 17 and 18.

Revenue reclassifications are to be made on the hospital's books and records prior to entering the trial balance amounts on the revenue report pages (Report Pages 12 and 14).

Reclassification, as discussed in this Manual, are of three types:

- (1) Reclassification to obtain the required level of reporting.
- (2) Reclassification to correct "dislocations" of a given type of patient care service which affect revenues and costs, and
- (3) Reclassification to correct accumulation of costs.

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The first type of reclassification may be necessary to reach the required level of reporting because the hospital has combined several departments. For instance, smaller hospitals may be combining the costs of acute and intensive care in one nursing unit cost center. In such cases, it is necessary to reclassify the total direct costs incurred in the two different types of care into two specific cost centers relating to these two types of services.

The second type is necessary when "overflow" patients are treated in cost centers other than the functional center relating to the services provided (e.g., a Medical/Surgical acute patient treated in an intensive care unit because all Medical/Surgical beds were occupied).

The third type of reclassification, to correct the accumulation of costs, would be necessary when expense associated with a particular function is recorded in a cost center different from the functional description specified in this Manual. For instance, a reclassification would be required if Dietary recorded the costs associated with hand-feeding of patients, because these costs should have been recorded in the Daily Hospital Services cost center relating to that patient.

The following are examples of how a hospital may accumulate costs in one cost center and then reclassify the costs to the appropriate cost centers for year end reporting.

- 1) Plant maintenance - all plant maintenance costs accumulated in the plant maintenance cost center (8460) during the year, with work order information accumulated during the year relative to significant, non-routine work for which costs must be transferred. Actual transfers would then be made at year end on the accounting records to individual cost centers for which the work was done.
- 2) Depreciation - depreciation may be accumulated in one cost center (8810) during the year but adjustments must be made on the accounting records at year end to transfer depreciation on major moveable and minor equipment specifically identifiable to individual cost centers to those cost centers.
- 3) Employee benefits - employee benefits may be accumulated in one cost center (8880) during the year with adjustments made on the accounting records at year end to relate payroll-related employee benefits to specific cost centers.

The following reclassification matrices indicate the cost center which should be charged with the cost of providing certain functions. If these expenses have not been included in direct costs of the indicated cost center, a reclassification is required, if material. Materiality is defined as a distortion of the cost per unit of service by more than five (5) percent in either cost center. The effect of reclassification is cumulative. One reclassification may not distort the cost per unit of service by five percent distortion. Therefore, these would be material and must be made.

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These reclassifications may be computed on any one of the following bases:

- 1) Analysis of direct expenses including time and cost studies.
- 2) Ratio of total charges to charges of a specific cost center.
- 3) Ratio of total units of service to units of service being reclassified in a specific cost center.







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**Functional Reclassification Matrix  
Responsibility Reporting Centers**

Type 2 Functions Requiring Reclassification		Ancillary Services																																													
		Line No.	Labor and Delivery Services	Surgery and Recovery Services	Ambulatory Surgery Services	Anesthesiology	Medical Supplies Sold to Patients	Durable Medical Equipment	Clinical Laboratory Services	Pathological Laboratory Services	Blood Bank	Echocardiology	Cardiac Catheterization Services	Cardiology Services	Electroencephalography	Radiology - Diagnostic	Radiology - Therapeutic	Nuclear Medicine	Magnetic Resonance Imaging	Ultrasonography	Computed Tomographic Scanner	Drugs Sold to Patients	Respiratory Therapy	Pulmonary Function Services	Renal Dialysis	Lithotripsy	Gastro-Intestinal Services	Physical Therapy	Speech-Language Pathology	Occupational Therapy	Other Physical Medicine	Electroconvulsive Therapy	Psychiatric Psychological Testing	Psychiatric Individual/Group Therapy	Organ Acquisition	Other Ancillary Services	Purchased Inpatient Services										
Abortion	18		X																																												
Psychiatric Day/Night Care	19																																														
Lab Svcs - Inpatient Ambulatory	20						X																																								
Blood Bank	21							X																																							
Cardiology Services	22								X																																						
Electrodiagnostic Services	23									X																																					
Radiology Svcs - Inpatient, Ambulatory	24										X																																				
Drug Sold to Patients - Inpatient, Ambulatory	25															X																															
Respiratory Therapy - Inpatient Ambulatory	26																					X																									
Physical Medicine - Inpatient Ambulatory	27																																														
General Anesthesia Services	28																																														
Local Anesthesia Services	29																																														
Surgery - Inpatient	30																																														
Surgery - Minor - Ambulatory	31																																														
Surgery - Minor - Clinic	32																																														
Surgery - Minor - ER	33																																														
Ambulance Services	34																																														
Labor and Delivery Services	35		X																																												
Surgery - Minor Gynecological	36		X																																												
Med Supplies Sold to Patients - Inpatient, Ambulatory	37																																														
Imaging Services	38																																														
Psychiatric Therapy Services	39																																														





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**Functional Reclassification Matrix**  
*Responsibility Reporting Centers*

Line No.	Type 3 Functions Requiring Reclassification	Miscellaneous				Research		Educational											General Services																						
		Medical Records	Admitting and O/P Registration	Cost Center to which Asset is Assigned	Nursing Unit to which Patient is Assigned	Ancillary Service Making the Charge	Cost Center to which Employee is Assigned	Research Projects and Administration	Education Administrative Office	School of Nursing	Licensed Vocational Nursing	Medical Post Graduate Education	Paromedical Education	Student Housing	Other Health Profession Education	Printing and Duplicating	Kitchen	Non-Patient Food Services	Dietary	Laundry and Linen	Social Work Services	Central Transportation	Central Services and Supplies	Pharmacy	Purchasing and Stores	Grounds	Security	Parking	Housekeeping	Plant Operations	Plant Maintenance	Communications	Data Processing	Other General Services							
21	Purchasing, Receiving, Storing Processing, Issuing Blood					X																																			
22	Collecting, Assembling, Sterilizing & Redistributing Items																								X																
23	Drawing Blood Samples				X																																				
24	Collecting Urine, Sputum and Feces Specimens				X																																				
25	Serving and Feeding of Patients				X																																				
26	Operating Specialized Equipment for Monitoring Life Signs				X																																				
27	Bathing Patients				X																																				
28	Administering Medications				X																																				
29	Keeping Patients Room in Order				X																																				
30	Operating Equipment to Diagnose and Treat Patients				X																																				
31	Infusing Fluids				X																																				
32	Administering Oxygen and Therapy Cases				X																																				
33	Laundry Pickup and Delivery																																								
34	Inservice Education (Non-Teaching Employees)																																								
35	Teaching Students on Approved Programs																																								
36	Performing Research																																								
37	Transcribing Physicians Reports																																								
38	Registering Patients																																								
39																																									
40																																									

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Type 1 - Functional Reclassifications

Reporting at Required Organizational Unit Level

The revenues, costs, and statistics of each daily hospital, ambulatory and ancillary services listed on Report Page 12 must be reported on the appropriate lines and pages if the hospital has such an organizational unit(s) or if beds have been specified by the hospital for such types of care. If neither is the case, but patients are admitted by the clinical categories or intensity of care categories listed therein, the revenues, costs, and units of service must be reclassified as a Type 2 functional reclassification.

Type 2 - Functional Reclassifications

To Correct "Dislocations" of a Given Type of Patient Care Service

It is recognized that from time to time it will be necessary to admit patients into cost centers providing more intensive care than the patient requires, due to space and other problems. Likewise, it is occasionally necessary to mix major clinical patient categories (i.e., Psychiatric patient in Medical/Surgical unit). The revenues, costs, and statistics associated with these situations must be reclassified per the reporting requirement.

Functional Reporting Matrix M2 is provided to assist in identifying these requirements.

Type 3 - Functional Reclassifications

Corrections to Accumulated Costs

Many activities are common to each cost center and therefore give rise to reclassification if the costs are being assigned to another cost center on its behalf and are material.

Activities common to most functional cost centers such as planning, appraising, analyzing, preparing staffing schedules, meeting legal requirements and sanitary standards, keeping abreast of applicable fields, clerical work incidental to the activities of the functional reporting center, documenting work performed, initiating requisitions, the provision for and receipt of in-service education, educating patients for self-care, maintaining specialized libraries, preparing budgets, evaluating assigned personnel, and attending meetings shall be assigned to the functional reporting center in which the activity is performed. The operation of equipment includes preventive maintenance such as cleaning, oiling, and calibration.

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Other activities are unique (as herein defined) and their cost must be reported per the cost center functional descriptions. If the cost of these activities are accumulated in a different cost center, they must be reclassified. To assist in the identification of these, a sample list of functions whose costs must occasionally be reclassified is included in Functional Reclassification Matrix M3 along with the centers to which they must be reclassified if they are material