

## Chapter 6

# Managing Activity-Based Funding Using Costing Data and Activity-Based Budgets

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### **ABSTRACT**

*This chapter will show how detailed information from an activity-based costing (ABC) system can be used to support activity-based funding (ABF) by providing management with a detailed perspective of the activity and how it can be used to internally model the allocation of target activity to build an activity-based budget (ABB). By building a set of internal cost weights based on ABC data, this chapter will show how activity forecast in a funding agreement can be broken up and applied to the individual cost centers that contributed to the activity in the current year. Building an ABB provides an evidence base for the overarching hospital budget and encourages the adoption of a focus on efficiency by hospital departments.*

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## **INTRODUCTION**

Activity Based Costing (ABC) provides detailed information on the cost of the individual patient encounter and provides the basis for the development of an Activity Based Funding (ABF) model. The challenge for management within the health service is how to best use this detailed patient costing information to allow it to effectively manage the Activity Based Funding.

## **BACKGROUND**

Within the Australian funding methodology, the main source of revenue for most large public hospitals is via Activity Based Funding. This funding is allocated using a standard unit of measure called a WAU or Weighted Activity Unit. A WAU is a measure of the relative resource usage required to generate the output activity. It varies from output group to output group. Australia uses different groupings for different types of activity. For acute inpatients, the output activity is grouped into Diagnosis Related Groupings (DRGs), with a modified version being used in the national model for Mental Health Inpatients. Non-acute patients use the SNAP (Semi- & Non-Acute Patients) grouping, Outpatients use Tier-2 clinic groupings, whilst Emergency Department encounters use URGs (Urgency Related Groupings). All the patients in these different types of activity have their encounters grouped up into the relevant grouping, and each grouping has a relative weight designated in WAU that is indicative of the resources required to produce that activity so, for example, the WAU associated with a kidney transplant is many times more than might be generated by a carpal tunnel release.

Of course, each individual patient encounter has a cost. This cost will vary for every patient, even those within the same grouping. Hence, for example, each individual kidney transplant patient encounter is likely to have a different cost from every other kidney transplant encounter, because they will have a different length of stay, time in theatre, different drugs, diagnostic tests, and all the other items that will vary from encounter to encounter, and consequently change the total cost. From a financial perspective, the key point of interest is the relationship between this cost and the revenue received for the patient. Just as the price weight that determines the revenue is based on an average cost from a statistically large population, then the average cost within the hospital for a particular group of patients should be fairly consistent, as should the manner in which those costs are built up from all the different services the patients receive.

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