Essentials of
COST ACCOUNTING
for
HEALTH CARE ORGANIZATIONS

Third Edition

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To Lilli, Joanne, and R.W. (the Bear)
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Cost accounting is an essential part of health care management. As managed care has taken hold, all health care organizations have increased their focus on the measurement and control of costs. All health care managers, not just accountants, are becoming more and more aware of the importance of understanding as much about costs as they possibly can.

A number of textbooks are available in the cost accounting field. However, these generic cost accounting texts focus primarily on manufacturing industries and only secondarily on service industries such as health care. Their emphasis is therefore largely on the process of converting raw materials into finished goods. Such books give a great deal of attention to determining the cost of work-in-process and by-products. However, cost accounting texts written expressly for health care are scarce.

This book thoroughly covers the essentials of cost accounting from a health care perspective, including all of the basic tools of cost accounting common to all industries, using health care examples. Essentials of Cost Accounting for Health Care Organizations, Third Edition, focuses on costing issues and concepts unique to the health care field. The tools covered are all practical, although not all are commonly used. Some approaches, such as learning curves, are commonly used in other industries but not in health care. It is our hope that readers will see the value of some of these less frequently used techniques and adopt them for use in their organizations.

The main theme of the book is the generation of useful cost information to aid managers in making decisions. The contents are therefore oriented toward both current and future accountants who will generate the information, as well as all current and future health care managers who want to know the types of information potentially available.

Essentials of Cost Accounting for Health Care Organizations does not rely heavily on debits, credits, journal entries, and other technical accounting terminology. This omission was intentional to make the book accessible to a wide range of readers—students and faculty in university programs for health administration (both undergraduate and graduate), as well as individuals already working in the field of health administration. The need to obtain improved information to facilitate decisions is critical at all levels of management.

In keeping with the first and second editions, this book provides a thorough conceptual foundation. In this third edition, we have continued to follow the trend of the health care industry, moving away from a dominant focus on hospitals. The concepts and examples used in the text address not only hospitals but also nursing homes, physician practices, managed care organizations, clinics, surgicenters, and a wide range of other types of health care organizations.
In the third edition, we also continue to integrate personal computers (PCs) and the internet. Many chapters provide examples designated as “Excel® Problems.” These problems are specifically designed to be solved with a computer-based spreadsheet application like Microsoft Excel®. In addition, we have created ancillaries at www.jbpub.com/catalog/0763738131 that include data sets and Excel® templates that readers can download to solve the Excel® problems. On this site, we also include instructions on specific Excel® tasks related to the chapters and the problems.

The text is broken into four parts. Part I provides the foundations of cost accounting. Part II addresses the use of cost accounting for planning and control. Part III provides additional cost accounting tools to aid in decision making, and Part IV discusses the latest trends and techniques in cost accounting.

Part I provides the reader with a solid base in the essentials of cost accounting. The chapters in this section introduce costing and cost definitions. Various approaches to product costing and cost allocation are discussed. Breakeven analysis is also covered in the section, as are techniques for making non-routine decisions.

A primary focus of cost accounting is on developing information that managers can use for planning and control. Once the reader is familiar with the foundations of cost accounting provided in Part I, Part II presents a number of specific tools for improved planning and control. The chapters in this section focus on forecasting and predicting future costs, budgeting, flexible budgeting and variance analysis, and management control.

Part III addresses a number of additional cost accounting tools that can be helpful in generating management information for decision making. Specifically, there are chapters on cost accounting ratios, productivity measurement, inventory, uncertainty, information systems, and performance evaluation.

For the past several decades, literature critical of current cost accounting practices throughout all U.S. industries has been growing. The concern is that costing has evolved primarily into a tool for external reporting of financial results rather than for managing the organization. This concern has led to a movement to revise cost accounting practices drastically to make them more relevant. The criticisms of cost accounting and a number of suggested approaches for improvement are discussed in Part IV. A new chapter about activity-based costing has been added to this third edition. The chapters in this part also examine total quality management and the future of costing.

The last chapter summarizes the book. Some instructors may choose to assign this last chapter at the beginning of the course to provide an in-depth overview of the material. It can then be assigned again at the end, for review, and to integrate the great breadth of material covered in the book.

Each chapter begins with a set of specific learning objectives listed for the reader. In addition, we present key application questions, which serve as examples of typical questions readers will be able to answer after completing the chapter. The key application questions are followed by a set of key terms used in the chapter. Each of the key terms is shown in boldface italics the first time it appears in the chapter, and all are defined in the glossary at the end of the book. Each chapter has exercises and questions for discussion.

An instructor’s manual is available online for instructors who adopt the book for classroom use. The manual includes solutions to all questions and problems at the end of the chapters and an examination test bank with solutions, along with PowerPoint slides arranged by chapter.

While the task of updating and revising is certainly easier than creating, putting together the third edition of this book proved to be quite a challenge. We have attempted to create a book that provides
a thorough, clearly written, comprehensive coverage of cost accounting. However, we recognize that there is always room for improvement. Readers are encouraged to use the resources at www.jbpub.com/catalog/0763738131 to email us to point out errors or unclear passages, or to suggest additional applications or other improvements. All contributions will be acknowledged in the next edition. Any corrections to errors in the text will be posted on the Web page.

Our thanks go to the many individuals who helped us in the process of developing this book.

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