

COUNCIL OF TEACHING HOSPITALS
ASSOCIATION OF AMERICAN MEDICAL COLLEGES
1346 Connecticut Avenue, N.W.
Washington, D.C. 20036
202/223-5364

AGENDA

COMMITTEE ON FINANCIAL PRINCIPLES FOR TEACHING HOSPITALS
SEVEN CONTINENTS V.I.P. LOUNGE
O'HARE INTERNATIONAL AIRPORT
Chicago, Illinois
Thursday, June 6, 1968
10:00 a.m.-4:00 p.m.

- I. Call to Order: 10:00 a.m.
- II. Approval of Minutes: Revised Minutes of 1/25/68 Meeting Circulated
- III. Welcome to New Member: Francis J. Sweeney, Jr., M.D., Hospital Director
Jefferson Medical Center Hospital
Philadelphia, Pennsylvania
- IV. Discussion of Budgetary Problems Relating to General Clinical Research Centers:

Thomas J. Kennedy, Jr., M.D., Director
Division of Research Facilities and Resources
National Institutes of Health

William R. DeCesare, M.D., Chief
General Clinical Research Centers Branch
Division of Research Facilities and Resources
National Institutes of Health

Kenneth A. Anderson, Grants Management Officer
Division of Research Facilities and Resources
National Institutes of Health

Robert B. Millman, M.D., Program Specialist
General Clinical Research Centers Branch
Division of Research Facilities and Resources
National Institutes of Health

- V. Review of Statement of Financial Principles for Teaching Hospitals as Submitted by the Subcommittee
- VI. Other Business
- VII. Adjournment: Not later than 4:00 p.m.

Luncheon will be served in the meeting room at 12:30 p.m.

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MEETING OF COMMITTEE ON FINANCIAL PRINCIPLES
FOR TEACHING HOSPITALS
SEVEN CONTINENTS V.I.P. LOUNGE
O'HARE AIRPORT
CHICAGO, ILLINOIS
January 25, 1968
10:00 a.m. - 4:00 p.m.

Present:

Charles R. Goulet, Chairman
Richard D. Wittrup, Vice-Chairman
V. L. Harris
Gerhard Hartman, Ph.D.
Arthur J. Klippen, M.D.
Bernard J. Lachner
Lawrence E. Martin
Roger B. Nelson, M.D.
Irvin G. Wilmot
Robert C. Linde, AHA Representative

Staff:

Matthew F. McNulty, Jr., Director, COH; Associate Director, AAMC
Fletcher H. Bingham, Ph.D., Assistant Director, COH
Lee Powers, M.D., Director, Division of Operational Studies (Portion of
afternoon only)
Thomas J. Campbell, Assistant Director, Division of Operational Studies, AAMC
A. J. Carroll, Assistant Director, Division of Operational Studies, AAMC

Also Present:

Roger L. Amidon, Ph.D.

Absent:

Reid T. Holmes

I. Call to Order:

The meeting was called to order at 10:00 a.m. by Charles R. Goulet,
Chairman

II. Approval of Minutes

The minutes of the October 17 meeting of the Committee on Financial Principles for Teaching Hospitals were approved as previously circulated.

III. Discussion: Selected Financial Principles

Mr. Goulet noted that he had provided the selected principles (see attached) in order to present a point of departure for the Committee's deliberations. After discussion regarding the substantive content of the principles, and with special emphasis on the thought that the development of any financial principles may be somewhat arbitrary and based on assumptions as well as analysis, there was concern expressed by some members of the Committee regarding the wisdom of attempting to develop such principles.

Mr. Goulet and Mr. Wittrup, two members of the Executive Committee, then commented on the underlying rationale that had been exhibited by the Executive Committee in forming this Committee and providing its charge. After lengthy discussion regarding this proposal, the Committee agreed.

ACTION #1: THE CHAIRMAN APPOINT A SUBCOMMITTEE WHICH WOULD DEVELOP A STATEMENT OF FINANCIAL PRINCIPLES FOR TEACHING HOSPITALS FOR REVIEW, CONSIDERATION AND ACTION BY THE FULL COMMITTEE.

ACTION #2: THAT EACH MEMBER OF THE COMMITTEE WOULD REVIEW THE DRAFT STATEMENT OF FINANCIAL PRINCIPLES PREPARED BY MR. GOULET AND WOULD WRITE TO HIM, FOR FUTURE SUBMISSION TO THE SUBCOMMITTEE, EITHER REFINEMENTS IN THE CONTENT, OR OTHER SUBSTANTIVE AREAS WHICH THEY FEEL SHOULD BE INCLUDED.

IV. Discussion: P.P.B.S. - A Design Potential for Teaching Hospitals

Dr. Hartman commented on the paper prepared by he and Roger L. Amidon, Ph.D., noting particularly the need for a position statement relating to the need for awareness, analysis and introduction of new and sophisticated managerial and fiscal techniques in teaching hospitals. He noted further that the concept of P.P.B.S. was being systematically implemented in various Federal agencies, including the Department of Health, Education and Welfare. Following the discussion, the Committee agreed to:

ACTION #3: URGE, THROUGH COTH STAFF, TO THE EDITOR OF THE JOURNAL OF MEDICAL EDUCATION, THAT THE PAPER "P.P.B.S. - A DESIGN POTENTIAL FOR TEACHING HOSPITALS" BE GIVEN EVERY CONSIDERATION FOR EARLY PUBLICATION BY THE JOURNAL.

V. Selected Problems of Medicare Reimbursement

Mr. Wittrup introduced several problem areas of medicare reimbursement which he was experiencing. Following his presentation, there was a general discussion during which it was noted that the items which he had noted were being handled differently in different geographical regions.

VI. Problems of Inadequate Overhead on Direct Research Grants and Training Grants

Mr. Goulet noted that this item had been referred to the Committee on Financial Principles for Teaching Hospitals by the Committee on Modernization and Construction Funds for Teaching Hospitals at their meeting of December 12. Mr. Goulet noted further that the question had been originally introduced by Mr. Richard T. Viguers, the Chairman of that Committee. Mr. Martin noted that, as a member of the Department of Health, Education and Welfare's Grants Administration Advisory Committee, he knew

of this problem and that he had been in contact with both DHEW and the BOB. He noted that there was some interest exhibited in removing the 8% indirect cost overhead on training grants, but that it would be necessary to provide appropriate data supporting its removal. After further discussion the following actions were introduced.

ACTION #4 THERE WAS A UNANIMOUS EXPRESSION THAT THE 8% CEILING ON INDIRECT COSTS FOR TRAINING GRANTS WAS AN UNNECESSARY HARDSHIP ON HOSPITALS.

ACTION #5 THAT COTH STAFF CONTACT MR. IRVING J. LEWIS, DEPUTY DIRECTOR, BOB, STRONGLY URGING THAT THE 8% CEILING BE REMOVED, AND FURTHER NOTING THAT THE COUNCIL, THROUGH THE COOPERATION OF HOSPITALS IN THE BOSTON AREA, WOULD BE WILLING TO PROVIDE ADDITIONAL INFORMATION IN SUPPORT OF THIS REQUEST AS DESIRED.

ACTION #6 THAT THE AMERICAN HOSPITAL ASSOCIATION BE URGED TO CONSIDER THE ADVISABILITY OF CONTACTING THE VARIOUS APPROPRIATE FEDERAL AGENCIES IN SUPPORT OF THE REMOVAL OF THIS CEILING.

ACTION #7 THAT COTH STAFF BRING THIS ITEM TO THE ATTENTION OF THE AAMC EXECUTIVE COUNCIL URGING THAT THIS COUNCIL RECORD ITS SUPPORT OF THIS COTH COMMITTEE ACTION.

VII. Report: Recent Developments Regarding A Guide to Hospitals: Establishing Indirect Cost Rates for Research Grants and Contracts with the Department of Health, Education and Welfare.

Mr. McNulty reported that there had been recent correspondence between the AHA and Mr. James F. Kelly, Comptroller, DHEW, in which the AHA once again noted that the Guide had not had the concurrence of the AHA prior to its distribution as had been asserted by DHEW. Mr. McNulty noted further

that although this exchange of correspondence documented the resolution of a previous misunderstanding, that the Guide was now published and activities were ongoing regarding its implementation.

VIII. Report: Activities of DHEW Committee to Develop Implement Procedures for Hospital Cost Principles and Its Subcommittees

Dr. Bingham reported that the full Committee had met on October 23 to consider the implementation at which time a subcommittee had been appointed to develop the necessary procedures. He noted that the subcommittee had met four times since October, including one meeting each at Passavant Memorial Hospital (Chicago, Illinois) and Memorial Sloan-Kettering Hospital (New York) in order to develop such procedures. He noted further that this subcommittee was not considering the problem of the four non-allowable items contained in the Guide; depreciation on Federally financial buildings and equipment, interest, bad debts and gain or loss on sale of plant and equipment.

ACTION #8 THE COMMITTEE AGREED THAT ITS POSITION ON THIS ITEM SHOULD BE THAT THERE BE ONLY ONE, RATHER THAN MULTIPLE COST REPORTING FORMATS FOR THE DHEW. ADDITIONALLY, THERE WAS AGREEMENT THAT BOTH STAFF SHOULD CONTACT APPROPRIATE OFFICIALS WITHIN THE BOB EXPRESSING ITS CONCERN ABOUT THE NONALLOWABLE COSTS OF THE FOUR ITEMS AS CONTAINED IN THE GUIDE.

IX. Report: Recent Revision of Protocol for AAMC - DHEW Cost Allocation Study

Mr. McNulty reported that, in a recent letter to Secretary Gardner, Mr. Nathaniel H. Karol had indicated that the "study's principle objective is to develop a model system of program cost finding for each component of the medical center complex." He continued that these were not in accord

with his understanding of the purposes of the study. Dr. Powers, Director, Division of Operational Studies, had joined the meeting, and indicated that although he did not feel this to be a matter of major concern, he would write to Mr. Karol questioning him about the use of the term "model system". After further discussion, it was agreed that:

ACTION #9 COTH STAFF WOULD DISTRIBUTE TO EACH HOSPITAL REPRESENTED IN THE COST FINDING STUDY A COPY OF THE ORIGINALLY AGREED UPON OBJECTIVES OF THE STUDY. FOLLOWING THIS DISTRIBUTION, EACH MEMBER WOULD CORRESPOND WITH THE CHAIRMAN, (WITH A COPY TO COTH STAFF) INDICATING THEIR OWN PERCEPTION OF THE GRAVITY OF THE DEVIATION OF THIS MOST RECENT REVISION BY MR. KAROL FROM THE ORIGINAL DOCUMENT.

X. Physician Services for "Staff" or "Service" Patients

Mr. Wittrup noted that upon reading the datagram on "Educational Support Needs of Schools with Limited Financial Resources", he was reminded again of the cost which many schools must be bearing in connection with providing physician "services" to service patients. He indicated that he felt this to be an important issue, first because of the drain against education resources which might be involved, and second, because of the financial leverage, comparable to that resulting from research grants, which a medical school might acquire with professional fee income.

Following lengthy discussion, there was a consensus of opinion that the full efforts of the Committee should be directed toward the completion of the AAMC-DHEW Cost Finding Study before any additional statistical data be developed. There was further opinion expressed that, upon completion of this study, information may be available, which could be of benefit in answering questions of this nature.

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XI. Other Business

Mr. Goulet asked Mr. A.J. Carroll how he stood with regard to the completion of the Yale-New Haven study. Mr. Carroll noted that with two to three weeks of concentrated effort, the study might be completed. He noted, however, that he was unable to "free up" any such period.

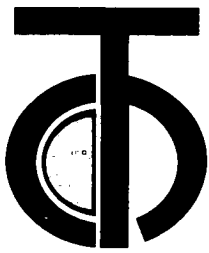
ACTION #10 IT WAS AGREED THAT MR. McNULTY WOULD DISCUSS WITH AAMC THE POSSIBILITY OF PROVIDING MR. CARROLL WITH ENOUGH TIME, WITHOUT OTHER RESPONSIBILITIES, TO COMPLETE THE REMAINDER OF THIS STUDY.

XII. Date of Next Meeting

The date of the next meeting was set for Thursday, June 6, 1968.

XIII. There being no further business, the meeting adjourned at 3:45 p.m.

1. Because of the multiple purposes of a medical center, it is essential that costs related to research, education, and patient services be separated.
2. The separation of costs should not only be made by major category, but should also be made by specific programs within each category, e. g. in-patient services, out-patient services, etc.
3. The separation of costs should be based upon sound cost accounting principles.
4. The bases for allocation of costs should be well understood within the institution and, where necessary, within the community and by third parties.
5. Although it is essential that a number of the functions in a modern medical center must be carried out simultaneously, and indeed it is essential that they be done so, institutions should arrive at reasonable bases for the allocation of expenses between the major functions and programs.
6. General educational research costs should be borne by the University, except where there is clear assignment of such educational or research responsibilities to the hospital.
7. If research and educational costs are assigned to the hospital, full reimbursement for these costs should be provided from available sources whether from the community, university or institutional sources.
8. The costs related to education and research, where conducted within the hospital setting, should include costs associated with the provision, replacement and maintenance of capital facilities.
9. Distribution of costs for physicians' services should be carefully considered by the medical school and the hospital in relation to service, education and research. The method of apportionment should be well understood and should be based upon a realistic appraisal of the prevailing situation. The costs associated with undergraduate educational programs should be separated from the costs of graduate medical education.



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COTH

Special Membership Memorandum

May 28, 1968

Subject: May 23rd Memorandum from General
Clinical Research Center Branch
Regarding Budgetary Projections

A memorandum of May 23rd from William DeCesare, M.D., Chief, General Clinical Research Centers Branch; Division of Research Facilities and Resources, National Institutes of Health, has just come to our attention, as a result of telephone calls from directors of teaching hospitals.

It was addressed to the CRC Principal Investigator with a copy to financial officers. It requests submission by June 15th of two budgetary projections predicated on 87.5 per cent of the current operating level and 75 per cent of the current operating level of each CRC.

The COTH Committee on Financial Principles for Teaching Hospitals will meet on June 6th and will discuss this subject. The period from a June 6th meeting to the June 15th submission deadline is very short. However, following the June 6th meeting, your COTH headquarters will issue a special memorandum reviewing the situation and the recommendations of the Committee as to possible affirmative alternatives of least adverse impact on teaching hospitals. Of course, this proposed congressional budget economy of \$6 billion, if enacted will obviously dictate drastic economy actions by federal administration officials responsible for rational fiscal management of their programs.

Any comments or recommendations, you may wish to have brought to the attention of the Committee regarding this action and any alternatives to it, should be forwarded to your COTH headquarters as quickly as possible.

MATTHEW F. McNULTY, JR.
Director, COTH
Associate Director, AAMC

DRAFT STATEMENT OF FINANCIAL
PRINCIPLES FOR TEACHING HOSPITALS

[Handwritten signatures and notes]
Committee
Revised
6-6

June 6, 1968
Prepared by Subcommittee
Richard D. Wittrup, Chairman
Bernard J. Lachner, Member
Irvin G. Wilmot, Member

STATEMENT OF FINANCIAL PRINCIPLES FOR TEACHING HOSPITALS

The Council of Teaching Hospitals, an integral component of the Association of American Medical Colleges, numbers among its membership the foremost teaching hospitals in the nation. These hospitals in addition to their responsibilities for patient care have a high degree of responsibility for both educational and research activities.

There has been a recognition by the membership of the Council that there is a need for a "Statement of Financial Principles for Teaching Hospitals" which emphasizes both the need for an identification of these costs and the need for reimbursement of such costs.

The following "Statement" is purposefully developed in a broad context to allow for individual institutional adaptation. It is recognized that teaching hospitals are located in a diversity of institution settings with a variety of administrative and organizational relationships. Additionally, as a result of the pressures of demand, growth and rising costs, the financial management problems of teaching hospitals have become more numerous and complex.

An awareness of these two issues; the need for individual institutional adaptation, and the demand for an increase in services have led to the development of the broad context within which the content of these principles are focused.

The membership of the Council is of the firm conviction that these principles can serve as useful guidelines for policy formation, as issues of financial nature are discussed with other individuals and agencies interested in the multipurposed activities that are accomplished in the teaching hospital.

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GUIDELINES FOR THE IDENTIFICATION OF
PROGRAM COSTS IN TEACHING HOSPITALS

1. Teaching hospitals serve multiple purposes in the teaching, research, and service components of the health industry. A number of public and private agencies are responsible for providing the funds needed to support specific programs conducted by teaching hospitals. Teaching hospitals, therefore, have responsibility for identifying, to a reasonable extent, the costs associated with each program element being so supported. This responsibility is in addition to the general obligation of management to identify and evaluate program costs.

2. The specifics of organizational patterns and institutional objectives vary greatly among teaching hospitals, so that each institution must determine for itself the criteria to be used in allocating costs, subject to the following:

- a. To safeguard the financial integrity of the institution it is essential that all costs, including such items as operating and capital costs as appropriate, be identified and allocated to programs.
- b. Criteria for allocating costs should be such as to produce an equitable distribution of costs among the various program elements.
- c. Criteria for allocating costs should be internally recorded and should be available to agencies which provide financial support to the hospital or which, for other reasons, have appropriate need for such information. Teaching hospitals, being public service institutions, should make every reasonable effort, consistent with these guidelines, to agree to the judgments of all agencies as to the reasonableness of the criteria being used. It is appropriate that the hospital's external auditor be required to examine and comment on the reasonableness of the criteria being used.

- d. Criteria for allocating costs, should be maintained with reasonable consistency from year to year. These criteria for allocating costs should be applied consistently among program elements to insure that all costs are allocated.

NOTE: Some agencies providing financial support to teaching hospitals exclude, or limit arbitrarily, certain cost items when calculating the amount of support to be provided. It must be recognized that these exclusions and limitations will make it impossible for teaching hospitals to conform fully to these guidelines.

3. The cost of any activity conducted by a teaching hospital should be allocated equitably among all of the major programs which benefit from it. This is in contradistinction to the incremental approach which allocates to a program only those added costs which a particular program element is believed to create. The incremental approach may be the only practical method applicable to minor and peripheral program elements, but when applied to basic programs tends to produce distorted cost figures and, consequently, to bias decision making procedures inappropriately.

NOTE: It is recognized that the incremental approach to cost allocation is widely prevalent in teaching hospitals and is the basis on which many agencies determine the amount of financial support which they provide to these institutions. It also is recognized that no generally accepted criteria currently exist by which costs may be allocated among programs with dissimilar outputs, i.e., patient care and research. However,

the consequences of the incremental approach are believed to be sufficiently undesirable that immediate effort should be directed towards the identification of methods by which these barriers can be overcome.

4. As a general rule, physician services to patients and hospital services to patients are financed from separate sources, e.g., Blue Cross and Blue Shield. A significant portion of physician services to patients in teaching hospitals commonly is provided by salaried physicians, including faculty members and house staff. Currently, methods of allocating the cost of these salaries vary considerably. To promote uniformity of approach and thus to facilitate the determination of responsibility for financing, teaching hospitals should identify the cost of physician services separately from the cost of hospital services.

5. Except when supported by funds provided specifically for the purpose, stipends and fringe benefits provided to individuals in learning capacities who also render services, should be considered to represent the cost of such services and allocated accordingly.

6. The identification of program costs and the reimbursement of such costs to teaching hospitals does not, by itself, provide the institution with a source of funds to support additions to working capital and capital expenditures not financed by depreciation reserves. While the prevailing concept of cost excludes such needs, it is reasonable to expect that each program conducted by a teaching hospital should generate its reasonable share of funds needed for these purposes. The amount of funds to be so generated should be based on a formal plan developed by each teaching hospital which takes into account all sources of such funds, including anticipated grants and loans, and justifies the need for such additions by indicating the approval of recognized planning agencies, where such exist, and by other appropriate means.