

CMS May Continue to Underpay Hospitals for the Most Costly Cases
Projected Impact of Outlier Payment As Proposed for FY2008

The Medicare Inpatient Prospective Payment System (IPPS) pays hospitals on the basis of pre-determined rates. The system includes numerous technical adjustments based on factors such as local area wage differences, a hospital's indigent caseload, and whether a hospital has a teaching program. The system also allows additional payment for cases that are unusually costly, referred to as "outlier" cases.

The complexity of the IPPS makes it difficult to gauge the effects of changes to a particular component of the payment system. Some components are patient-specific, some are hospital-specific, and some are interrelated with other components. The Medicare program announces proposed changes and updates to the IPPS each year but it can be extremely difficult for the industry to offer informed responses to the proposals.

One way to measure detailed impact is to use a base year of Medicare claims data and then compute IPPS payment on a patient-by-patient basis under existing and/or proposed payment regulations for various fiscal years. Such an analysis was performed using FY2006 Medicare inpatient claims with IPPS payment computed for fiscal years 2006-2008 according to respective regulations.

This analysis used the preliminary FY2006 MedPAR file that was used in promulgating the proposed regulations for FY2008. More than 3,000 short term acute care hospitals were included representing nearly \$110 billion in IPPS payments per year. Though statutory provisions call for 5-6% of total payments to be paid for outliers, the analysis showed total outlier payments below the provision and declining each year:

Projected IPPS Payment for Outliers as a Percentage of Total (\$billions)

	Total IPPS	Outliers	Outlier %
FY 2006	\$105.0	\$4.8	4.6%
FY 2007	\$109.0	\$3.9	3.6%
FY 2008	\$109.6	\$3.4	3.1%

Though this projection does not account for inflation in charges and changes in cost to charge ratios, it nevertheless indicates that proposed regulations may significantly underpay hospitals for treating unusually costly cases. Each 1% of underpayment represents a national shortfall of more than \$1 billion.

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