Rural and Smaller Hospitals Disadvantaged Under Proposed IPPS Regulations

Proposed changes to the Medicare inpatient prospective payment system (IPPS) by the Centers for Medicare and Medicaid Services (CMS) would significantly affect how hospitals are reimbursed for FY2008. These changes include the continued phase-in of relative weights based on hospital-specific costs and new Medicare severity-adjusted DRGs (MS-DRGs). The regulations would redistribute revenues among medical services and profoundly affect the bottom line for many hospitals.

The Medicare 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.

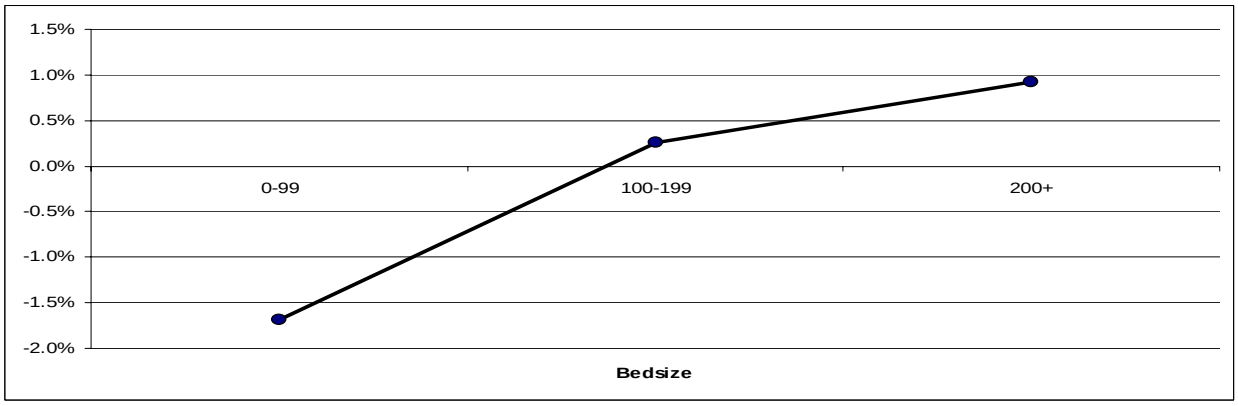
The complexity of the IPPS makes it difficult to gauge the effects of changes to a particular component of the payment system. Some components are patient-specific, some are hospital-specific, and some are interrelated with other components. It is also difficult to measure the effects for particular types of hospitals such as urban vs. rural or for categories such as bed size.

This analysis is based on the preliminary FY2006 MedPAR file that CMS used in promulgating the proposed regulations for FY2008. More than 3,700 short term acute care hospitals were included representing approximately $110 billion in IPPS payments per year. IPPS payment was then computed on a patient-by-patient basis under existing and/or proposed payment regulations for respective fiscal years. Each component of reimbursement was included in calculating payment: the respective DRG definitions, relative weights, hospital blended rate, outlier payments, capital payments, DSH adjustments, IME adjustments, transfer adjustments, etc.

The resulting computations of IPPS payment were then summarized by type of hospital (i.e. urban or rural) and by bed size (i.e. number of acute care beds available). Rural hospitals reclassified by CMS as urban were tabulated as urban.

Data indicate that larger hospitals tend to fare better under the proposed regulations than smaller hospitals.

Percentage change in IPPS Reimbursement for FY2007 vs FY2008 by Number of Acute Beds



There are two general characteristics that may help to explain the tendency. First, larger hospitals tend to attract more severely ill patients. Since the proposed MS-DRGs will allocate more payment to higher weighted severity levels there will be a shift or reimbursement from general services to higher levels of severity. Secondly, the continued phase-in of relative weights based on costs will cause some redistribution or reimbursement among medical services. Most notably, cardiovascular services will experience significant declines. The recent proliferation of small cardiovascular specialty hospitals may contribute to the losses projected for smaller hospitals.

Since rural hospitals tend to be smaller, rural hospitals as a group are expected to experience a 1.6% decline in IPPS reimbursement versus a 0.8% increase for urban hospitals. (These projections are based on short-term acute care hospitals only and do not include Critical Access Hospitals.)

Projected IPPS Payment by Urban vs Rural Classification and by Number of Acute Beds

Type/Beds	Number Hospitals	FY2006 IPPS Payment ($ million)	FY2007 IPPS Payment ($ million)	FY2007 % Change Inc/(Dec)	FY2008 IPPS Payment ($ million)	FY2008 % Change Inc/(Dec)
Urban						
0-99 beds	633	$3,931	$4,185	6.5%	$4,150	-0.8%
100-199	879	$17,739	$18,721	5.5%	$18,830	0.6%
200-299	485	$20,171	$21,199	5.1%	$21,359	0.8%
300-499	424	$28,007	$29,152	4.1%	$29,465	1.1%
500 +	185	$24,325	$25,076	3.1%	$25,333	1.0%
Total Urban	2,606	$94,173	$98,334	4.4%	$99,137	0.8%
Rural						
0-49 beds	432	$1,277	$1,323	3.6%	$1,267	-4.2%
50-99	373	$3,219	$3,382	5.1%	$3,323	-1.7%
100-149	142	$2,288	$2,375	3.8%	$2,348	-1.1%
150-199	65	$1,778	$1,843	3.7%	$1,820	-1.3%
200 +	49	$2,265	$2,348	3.6%	$2,331	-0.7%
Total Rural	1,061	$10,827	$11,271	4.1%	$11,089	-1.6%
Total	3,667	$105,000	$109,605	4.4%	$110,226	0.6%

TECHNICAL NOTES:
Data are based on the FY2006 MedPAR, December file. This is a file of 100% of all Medicare fee-for-service claims representing discharges during the 12 months ending September 30, 2006 and billed as of 12/31/2006. This is the same file used by CMS in promulgating the proposed IPPS regulations for FY2008. Only short-term acute care hospitals were included and hospitals were excluded if they did not have sufficient data to project IPPS for the periods studied. Hospitals were also excluded if their number of acute care beds could not be determined from cost report information. No adjustments were made to the data to account for inflation among the periods and no adjustments were made to disregard the "behavioral offset" proposed by CMS.

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