



Medicare Final Rule on Cost Outlier Payments Summary

In response to comments from WHA, the American Hospital Association, and others on its proposed rule to revise Medicare outlier payment policies, the Centers for Medicare and Medicaid Services (CMS) has modified the final rule in several ways. Most important, CMS has rejected the idea of an across-the-board settlement process, which would have been burdensome for all hospitals. On the other hand, CMS rejected recommendations to incorporate a transition period for the use of more current cost-to-charge ratios (CCRs). CMS published the final rule in the June 9 *Federal Register*. Following are details of the major provisions.

Cost-to-Charge Ratio

CMS originally called for immediately updating CCRs using tentative settled cost reports instead of final cost reports and would have required a mid-year methodology change. In the final rule, CMS will update the CCRs in this manner, but will delay implementation for most hospitals until October 1. The proposal would decrease the CCR lag time from a range of about three to five years to a range of one to two years.

In addition, CMS will apply an alternative CCR adjustment to a limited number of hospitals that “appear to have disproportionately benefited from the time lag in updating their cost-to-charge ratios.” If recent charge data indicate that a hospital’s charges have been increasing at “an excessive rate,” CMS will direct the fiscal intermediary to change the hospital’s CCR to reflect the high charge increases evidenced by the later data. This provision is effective 60 days after publication of the final rule. CMS will issue a program memorandum with implementation instructions.

CMS will also allow hospitals to request an adjusted CCR from the intermediary. Hospitals will be required to present evidence that the CCR is inaccurate. The CMS Regional Office will render final approval.

CMS rejected suggestions for a transition methodology for implementation of the new CCRs. CMS believes that a transition period would not be appropriate because it would result in higher outlier thresholds that would decrease payments for the majority of hospitals.

Outlier Settlement

CMS’ original proposal would have created a new outlier settlement process routinely applied to all hospitals. This would have required a recalculation of outlier payments when the cost report corresponding with the outlier cases is settled. The final rule will require a settlement only for those hospitals identified as having a disproportionately high growth in charges and high outlier payments. The intent is to establish the authority for CMS to reconcile outlier payments when there is evidence that a hospital was initially paid on a significantly inaccurate CCR. CMS states that this settlement process will be applied on only a limited basis. When reconciliation is required, payments will be adjusted to account for the time value of any underpayments or overpayments

CMS will issue instructions to fiscal intermediaries providing specific criteria for identifying those hospitals subject to reconciliation for the remainder of federal fiscal year (FFY) 2003 and for FFY 2004. According to CMS, the criteria for FFY 2003 will focus on only those hospitals that appear to have

disproportionately benefited from the time lag in updating their CCR. For cost-reporting periods beginning during FFY 2004, CMS is considering reconciliation for hospitals whose actual recalculated CCRs are found to be plus or minus ten percentage points from the CCR used to make outlier payments, and that have total FFY 2004 outlier payments that exceed \$500,000.

Statewide Average CCRs

Under the current methodology, the statewide average CCR is used in place of the actual CCR when the hospital's actual ratio is more than three standard deviations below the geometric mean CCR. CMS adopted this policy to provide a reasonable proxy when a hospital's own data were so far from the norm that it was assumed to be due to faulty reporting. Unfortunately, a few hospitals exploited this policy. The final rule will eliminate the use of the statewide average CCR and instead will use the hospital's actual CCR in these cases. This provision will be effective 60 days after publication of the rule.

Fixed Loss Threshold

To qualify for outlier payment, a case must have costs that exceed the "fixed loss threshold." This threshold is adjusted every year based on CMS projections of total outlier payments. The threshold for FFY 2003 outlier payments is \$33,560. Under the final rule, the outlier threshold will remain at the current level for the rest of FFY 2003. CMS projects that FFY 2003 outlier payments are equal to 6.1% of total Diagnosis Related Group payments and are still in excess of CMS' 5.1% target. CMS estimates that, after implementation of the FFY 2003 changes in the final rule, a slight increase in the threshold would still be required to reduce outlier payments to 5.1%. However, to avoid mid-year changes, CMS will keep the FFY 2003 threshold at \$33,560. The outlier rule does not estimate the threshold for FFY 2004; instead, it will be published in the final Inpatient Prospective Payment rule in early August.

The Medicare outlier final rule is available at http://www.wha.org/financeAndData/pps_inpatient.aspx.