



Minnesota Hospital Association

Memorandum

TO: Chief Executive Officers, Chief Financial Officers and
Directors of Reimbursement

FROM: Gregg Redfield, Vice President, Finance

DATE: August 2, 2006

SUBJECT: Final Medicare Rule for FFY 2007 Includes Changes to DRG
Weights

The Centers for Medicare and Medicaid Services (CMS) will revise how it calculates Diagnosis Related Group (DRG) weights beginning on October 1, 2006. However, CMS has substantially modified its new weight calculation method and will phase in the revisions over a three-year transition period. As a result, the extreme losses that some hospitals would have experienced under the original CMS proposal will be significantly reduced.

Various organizations and associations identified methodological and technical flaws with the proposal and recommended that CMS delay implementation for one year, working with the hospital field to ensure the proposal yields an equitable payment structure.

In response, CMS agreed to postpone implementation of its proposed Hospital Specific Relative Value cost center (HSRVcc) weight calculation methodology pending further evaluation. However, CMS believes that steps should be taken in federal fiscal year (FFY) 2007 to reduce the bias in the weights that result from the current charge-based calculations. Therefore, CMS calculated cost-based weights using national average cost-to-charge ratios to adjust the charges for each DRG to cost. Payments in FFY 2007 will be determined using a blend of 33% of the weights calculated using the new cost-based methodology and 67% calculated using the existing charge-based weight methodology.

The CMS final rule will greatly reduce the redistributive effects of the FFY 2007 weight revisions compared to the original proposal. In the proposed rule, CMS estimated that the revisions would increase the average weight for medical DRGs by 7.3% and reduce the weights for surgical DRGs by 6.9%. In the final rule, CMS estimates that the increase in the average medical DRG weight will be 0.9% and the decrease in the average surgical DRG weight will be 1.2% in FFY 2007.

CMS also responded to comments on its proposal to replace the current DRGs with severity-adjusted DRGs in FFY 2008. CMS accepted recommendations by commentators suggesting that CMS should reconsider the proposed severity-adjusted DRGs and evaluate alternative DRG refinements. However, in FFY 2007, CMS will take what it considers an interim step toward refined DRGs by creating 20 new DRGs and by modifying 32 others to improve recognition of severity within the existing DRG system.

Other significant provisions of the final rule include:

- **Marketbasket Factor:** Hospitals that submit data on required quality indicators will receive the full marketbasket update of 3.4%. A 2.0 percentage point reduction would be applied to hospitals that do not submit data as required by the Deficit Reduction Act of 2005. The number of required quality measures will be expanded from ten to 21. In response to comments, CMS eliminated a proposed policy that would have required hospitals to submit data for the new measures retroactively beginning with discharges that occurred in the first calendar quarter of 2006. Instead, hospitals will be required to complete and return a written form on which they pledge to submit data on the set of expanded quality measures starting with discharges that occur in the third quarter of calendar year 2006.

- **Wage Index:** In April, a U.S. Court of Appeals decision required CMS to recalculate the wage index occupational mix adjustment using more recent data for implementation on October 1, 2006. Given the short time available to collect and process these data, CMS was not able to calculate the final adjusted wage indexes for inclusion in the final rule. CMS states that the final wage indexes will be available in time to use for payments on October 1. MHA will provide further information on the wage indexes as it becomes available.

- **Outliers:** CMS will increase the outlier threshold from \$23,600 in FFY 2006 to \$24,475 in FFY 2007. CMS had proposed a greater increase in the threshold for FFY 2007, but responded to comments noting methodological flaws and shortfalls in prior year payments compared to the 5.1% outlier payment target.

The Medicare final inpatient rule for FFY 2007 is scheduled to be published in the August 18 *Federal Register*. A display copy of the rule is available at: <http://www.cms.hhs.gov/AcuteInpatientPPS/downloads/cms1488f.pdf>. Please note that the display copy is double-spaced and over 1,400 pages long.

A CMS Fact Sheet describing the DRG and weight revisions is available at <http://www.cms.hhs.gov/apps/media/press/release.asp?Counter=1922>

The Minnesota Hospital Association will provide members with a detailed summary of the final rule. If you have any questions, contact Joe Schindler, (651) 659-1415, jschindler@mnhospitals.org, or Gregg Redfield, (651) 603-3536, gredfield@mnhospitals.org.