Medicare outlier payments and hospital charging practices

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Overview

- The policy rationale for outlier payments
- How Medicare pays for outlier cases
- Two outlier policy issues:
  - Influence of charge markups
  - Calculation of outlier costs
- Potential changes to Medicare outlier policies
Policy rationale for outlier payments

- Medicare pays hospitals fixed payment rate for each MS-DRG
- Some patients are very high cost
- Outlier policy acts as a stop-loss insurance
Outlier payment formula

Outlier payment = 0.80 x 
(Total covered charges x Medicare CCR*) – (DRG payment + fixed-loss cost threshold)

Fixed-loss cost threshold in 2017 = $23,573**

*CCCR (cost-to-charge ratio)

**Adjusted by area wage index and COLA
What do outlier cases look like?

<table>
<thead>
<tr>
<th></th>
<th>Outlier</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of stay (days)</td>
<td>19.0</td>
<td>4.6</td>
</tr>
<tr>
<td>Average DRG weight</td>
<td>3.67</td>
<td>1.62</td>
</tr>
<tr>
<td>Cost per day</td>
<td>$3,393</td>
<td>$2,423</td>
</tr>
<tr>
<td>Cost per case</td>
<td>$64,552</td>
<td>$11,123</td>
</tr>
<tr>
<td>Payment per case</td>
<td>$40,967</td>
<td>$10,946</td>
</tr>
</tbody>
</table>

Data are preliminary and subject to change.
Share of cases that become outliers varies by MS-DRG

- Higher incidence in MS-DRGs with high weights, long average lengths of stay, and MCCs
  - Transplants
  - Major cardiac procedures
  - Major spinal procedures

- Lower incidence in low-weighted DRGs with short average lengths of stay, and no MCCs
  - Common medical conditions: e.g., COPD, heart failure, simple pneumonia
  - Major joint replacements
Share of cases that become outliers varies across hospitals


Data are preliminary and subject to change
Characteristics of 50 hospitals with highest share of outlier cases

- Most are small hospitals
- Majority are for-profit surgical subspecialty hospitals
  - Short length of stay for outliers (5.2 days)
  - High charge markups in operating room
  - High device costs
How can hospital charge markups affect outlier payments?

- **Mix of services** – More service use from departments with higher markups will result in higher outlier cost estimates and vice versa.
- **Differential markups** – Services with a higher than average markup within a department will also result in higher outlier cost estimates.
Average markups across cost centers

Source: MedPAC analysis of 2014 Medicare claims and cost reports.
Markups vary across hospitals

Median markup 3.2 times the cost of care

Source: MedPAC analysis of 2014 Medicare claims and cost reports.

Data are preliminary and subject to change
Weak relationship between markups and share of cases that are outliers

Source: MedPAC analysis of 2014 Medicare claims and cost reports.
How well does the total CCR work in estimating costs for outlier cases?

- Compare costs using total CCR and departmental CCRs
  - Departmental CCRs should provide a more accurate picture of hospital claim costs
  - Neither method will capture differential markups within a department
- In aggregate both give similar estimates of total outlier costs
...but at the case level the mix of services used will affect calculation of costs

<table>
<thead>
<tr>
<th></th>
<th>Routine</th>
<th>Operating room</th>
<th>Supplies</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>CCR</td>
<td>0.5</td>
<td>0.1</td>
<td>0.3</td>
<td>0.32</td>
</tr>
<tr>
<td>Charges</td>
<td>$40,000</td>
<td>$80,000</td>
<td>$30,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>Estimated Costs:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Departmental CCR</td>
<td>$20,000</td>
<td>$8,000</td>
<td>$9,000</td>
<td>$37,000</td>
</tr>
<tr>
<td>Total CCR</td>
<td>$12,800</td>
<td>$25,600</td>
<td>$9,600</td>
<td>$48,000</td>
</tr>
</tbody>
</table>

- If a case has a high share of services with higher markups, total CCR will give higher estimate of costs
- If a case has a high share of routine services—such as for patients with long stays—total CCR will underestimate costs
Potential changes to Medicare outlier policy

- Use hospital specific departmental CCRs to calculate case costs
  - Provides a more accurate estimate of case costs at the DRG and hospital level
  - Increases complexity of calculating outlier payments
- Establish a length-of-stay threshold for outlier claims
  - Reduces potential for gaming
  - Would eliminate many outlier claims for small surgical specialty hospitals
  - Should be relatively straightforward to implement
- Both policies would be budget neutral
Discussion

- Questions on analysis
- Discussion of policy options