



Highlights of [GAO-06-880](#), a report to congressional committees

Why GAO Did This Study

Under Medicare's inpatient prospective payment system (IPPS), hospitals generally receive fixed payments for hospital stays based on diagnosis-related groups (DRG), a system that classifies stays by patient diagnosis and procedures. CMS is required to at least annually update DRG payments to address changes in the cost of inpatient care. CMS uses charge-based weights to update these payments. Cost-based weights are used to set payments in the outpatient prospective payment system (OPPS). The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 required GAO to study IPPS payments in relation to costs. During the course of GAO's work, CMS proposed a new cost-based method for determining DRG weights. This report (1) examines the applicability of CMS's cost-based method—used for the OPPS—to weight DRGs in the IPPS and (2) evaluates whether CMS's proposed approach is an improvement over its OPPS method for setting cost-based weights. Using fiscal year 2002 cost reports and claims from 2001, 2002, and 2003 to examine the applicability of the OPPS method, GAO estimated costs for 1,025 IPPS hospitals whose Medicare cost reports most consistently reflected the total charges and number of Medicare stays that these hospitals reported on their claims. To evaluate CMS's proposed approach, GAO analyzed fiscal year 2003 cost reports and 2003 claims for 3,558 hospitals.

www.gao.gov/cgi-bin/getrpt?GAO-06-880.

To view the full product, including the scope and methodology, click on the link above. For more information, contact A. Bruce Steinwald, (202) 512-7101 or steinwald@gao.gov.

MEDICARE

CMS's Proposed Approach to Set Hospital Inpatient Payments Appears Promising

What GAO Found

If the OPPS method were applied to the IPPS, it could undermine the objective of better aligning DRG payment weights with actual costs. GAO estimated costs for 1,025 hospitals using CMS's cost-based OPPS weighting method to determine its applicability for weighting inpatient DRGs, and found that, for all but one of the 1,025 hospitals, GAO's application of CMS's OPPS method resulted in cost estimates for inpatient accommodation services that on average were 72 percent less than what the hospitals reported on their Medicare cost reports for these services. For 57 percent of the hospitals, GAO's application of CMS's OPPS method resulted in cost estimates for inpatient ancillary services that on average were 8 percent more than what the hospitals reported on their Medicare cost reports. For 22 percent of the hospitals, the application of CMS's OPPS method resulted in cost estimates for inpatient ancillary services that were on average 6 percent less than what the hospitals reported on their Medicare cost reports. These differences occur because the current OPPS weighting method does not address the variation in how hospitals allocate charges and costs in reporting Medicare services.

GAO found that CMS's proposed new approach to set payment weights for DRGs appears promising, and may result in improvements in setting cost-based weights compared with the OPPS method. CMS's proposed approach relies on grouping charges into 10 broad service groups, and converting those charges to cost-based weights by using national-average cost-to-charge ratios (CCR) that are derived from hospital data submitted to CMS. Use of national-average CCRs ameliorates the effects that variations in hospital charge and cost allocation decisions can have on DRG weights. GAO's analysis, using 2003 claims data and fiscal year 2003 cost report data for 3,558 IPPS hospitals, suggests that 6 of the service groups, which constitute a majority of Medicare inpatient charges, appear promising. GAO also found that wide ranges in the CCRs for 2 of the groups, the therapeutic services and operating room groups, raise concerns about their ability to better align payment with costs for those services. GAO did not have enough specific information to determine whether the remaining 2 groups are likely to capture the relevant cost-to-charge relationship for services in those groups.

In commenting on a draft of this report, CMS stated that it was pleased with GAO's findings. CMS also stated that it could not comment further because it is currently considering public comments in developing the fiscal year 2007 final rule for the IPPS payment rates. Hospital association reviewers agreed that cost estimation problems can result because of hospital reporting variation. However, they noted that because hospital reporting variation still affects the data CMS is proposing to use to set DRG weights, they were concerned with GAO's assessment that the CMS approach is promising. GAO believes the approach appears promising, in particular, because CMS proposes to use national-average CCRs to reduce the impact of individual hospital reporting practices.