
Program Memorandum Intermediaries

Department of Health &
Human Services (DHHS)
Centers For Medicare &
Medicaid Services (CMS)

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CHANGE REQUEST 2785

SUBJECT: Change in Methodology for Determining Payment for Outliers Under the Acute Care Hospital Inpatient and Long-Term Care Hospital Prospective Payment Systems

Regulations at 42 CFR §412.84 describe the criteria and procedures for determining whether an acute care hospital subject to the inpatient prospective payment system (IPPS) qualifies for an additional payment for extraordinarily costly cases, known as high-cost outliers. Regulations at 42 CFR §412.525 and §412.529 describe the criteria and procedures for determining whether a long-term care hospital (LTCH) subject to the LTCH prospective payment system (PPS) qualifies for high cost outlier and short stay outlier payments, respectively. A final rule, published on June 9, 2003 (68 FR 34494) revised the regulations at §412.84 for hospitals subject to the IPPS and at §412.525 and §412.529 for long-term care hospitals (LTCHs) subject to the LTCH prospective payment system (PPS). This Program Memorandum (PM) provides instructions for implementing those revisions to the outlier policy for the IPPS and the LTCH PPS.

Under the existing IPPS and LTCH PPS outlier methodologies, the CCRs from hospitals' latest settled cost reports are used in determining whether a case qualifies for payment as an outlier and the amount of any such payment. Based on the final rule published in the **Federal Register** on June 9, 2003, this PM provides instructions for applying CCRs for IPPS hospitals and LTCHs, including: the use of alternative CCRs when directed by CMS or at the request of the hospital and the use of CCRs based on tentative settlements of cost reports for discharges on or after October 1, 2003; use of the statewide average; the criteria for identifying hospitals to be subject to reconciliation; and notification to hospitals about those updates.

I. Use of More Recent Data for Determining CCRs

A. Changing CCRs For Hospitals Subject to the IPPS

Under the new §412.84(i)(1) implemented in the final rule published in the **Federal Register** on June 9, 2003, for discharges occurring on or after August 8, 2003, in the event more recent charge data indicate that a hospital's charges have been increasing at an excessive rate (relative to the rate of increase among other hospitals), as explained below, CMS may direct the fiscal intermediary to change the hospital's operating and capital CCRs to reflect the high charge increases evidenced by the later data. A hospital may also request that its fiscal intermediary use a different (higher or lower) CCR based on substantial evidence presented by the hospital. Before a change based on a hospital's request can become effective, the CMS Regional Office must approve the change.

Fiscal intermediaries are to perform data analysis to identify those hospitals that appear to have disproportionately benefited from the time lag in updating the CCRs using the latest settled cost reports. These are hospitals:

- 1) With current Federal fiscal year (FY) 2003 operating outlier payments of at least 10 percent of total operating diagnosis-related group (DRG) payments plus operating outlier payments;
- 2) Whose operating outlier payments relative to total operating DRG payments increased by at least 20 percent from either FY 2001 to FY 2002, or FY 2002 to FY 2003; and
- 3) Whose average charges per case increased by at least 15 percent both from FY 2000 to FY 2001, and from FY 2001 to FY 2002.

Fiscal intermediaries are also to perform data analysis to identify hospitals that received operating outlier payments in excess of 100 percent of total operating DRG payments for FY 2003 (outlier payments divided by DRG payments).

Effective for discharges occurring on or after August 8, 2003, for hospitals that are identified through the above data analysis, fiscal intermediaries are to use an alternative CCR rather than one based on the latest settled cost report (such as a CCR based on data from the latest tentative settled cost report or more recent data) to identify and pay for outliers under the IPPS. By July 25, 2003, for each of the hospitals identified, fiscal intermediaries should calculate a capital and operating CCR using the alternative data and submit this ratio to CMS (to the attention of Michael Treitel, e-mail at mtreitel@cms.hhs.gov). CMS will notify fiscal intermediaries whether to use these ratios or an alternative ratio. For all IPPS claims processed on or after August 8, 2003, until more accurate data becomes available, fiscal intermediaries are to use this approved alternative ratio.

B. Use of Alternative Data in Determining CCRs For Hospitals Subject to the IPPS and For Hospitals Subject to the LTCH PPS

Under new §412.84(i)(1) of the IPPS and §§412.525(a)(4)(ii), §412.529(c)(5)(ii) of the LTCH PPS, CMS may direct fiscal intermediaries to use an alternative CCR to the CCRs from the latest settled cost report (or after October 1, 2003, the later of the latest settled cost report or latest tentative settled cost report), if CMS believes this will result in a more accurate CCR. In addition, if the fiscal intermediary finds evidence that indicates that using data from the latest settled or tentatively settled cost report would not result in the most accurate CCR, then the fiscal intermediary should contact CMS to seek approval to use a CCR based on alternative data. Also, a hospital will have the opportunity to request that a different CCR be applied in the event it believes the CCR being applied is inaccurate. The hospital is required to present substantial evidence supporting its request. Such evidence should include documentation regarding its costs and charges that demonstrate its claim that an alternative ratio is more accurate. The CMS Regional Office must approve any such request after evaluation by the fiscal intermediary of the evidence presented by the hospital.

C. Ongoing CCR Updates Using CCRs From Tentative Settlements For Hospitals Subject to the IPPS and For Hospitals Subject to the LTCH PPS

For discharges beginning on or after October 1, 2003, fiscal intermediaries are to use CCRs from the latest settled cost report or from the latest tentative settled cost report (whichever is from the later period) to determine a hospital's operating and capital CCRs. By October 1, 2003, for all hospitals that are paid under the IPPS or LTCH PPS, fiscal intermediaries must update CCRs on the Provider Specific File (PSF) to reflect CCRs from the most recent tentative settlements or final settled cost reports, (whichever is the later period). These updated CCRs are to be used to process claims with discharge dates on or after October 1, 2003. The CCR on the PSF must be updated when that cost report is settled or when a cost report for a subsequent cost reporting period is tentatively settled, whichever is the latest cost reporting period.

In order to arrive at CCRs to be used in the PSF based on tentative settlement data, the intermediary should review previous adjustments used (if any) in the tentative settlement and take into consideration the impact of prior audit adjustments on prior period CCRs to determine if they had an impact on the CCRs. If these tentative settlement adjustments have no impact on the CCRs, or if no adjustments were made, the tentative settled CCRs will equal the CCRs from the hospital's as-filed cost report. If the adjustments made at tentative settlement would have an impact on the CCRs, the intermediary should compute new CCRs based on the tentative settlement. (Note: If the tentative settlement adjustments result in a difference in the CCR from the as filed cost report of 20% or less, then no adjustment to the CCR at tentative settlement is necessary.)

Following the initial update of CCRs for all hospitals for discharges on or after October 1, 2003, fiscal intermediaries should continue to update a hospital's operating and capital CCRs each time a more recent cost report is tentatively settled. Revised CCRs must be entered into the PSF not later than 45 days after the date of the tentative settlement or final settlement used in calculating the CCRs. Subject to the approval of CMS, CCRs may be revised more often if a change in a hospital's operations occurs which materially affects a hospital's costs or charges. Revised CCRs will be applied prospectively to all IPPS and LTCH PPS claims processed after the update.

II. Statewide Average for Hospitals Subject to the IPPS and for Hospitals Subject to the LTCH PPS

Currently, hospitals are assigned a statewide average CCR if their actual operating or capital CCR falls outside 3 standard deviations from the respective national geometric mean CCR. Effective August 8, 2003, a hospital will no longer be assigned the statewide average CCR when the hospital has a CCR that falls below 3 standard deviations from the national mean. Hospitals will receive their actual CCRs, no matter how low their ratios fall.

The statewide average CCRs may still apply in those instances in which a hospital's operating or capital CCRs exceed the upper threshold. In addition, hospitals that have not yet filed their first Medicare cost report may still receive the statewide average CCRs. CMS will continue to set forth the upper threshold (i.e., 3 standard deviations above the national geometric mean CCR) and the statewide CCRs applicable to IPPS hospitals and LTCHs in each year's annual notice of prospective payment rates published in the **Federal Register**.

III. Reconciling Outlier Payments For Hospitals Subject to the IPPS and For Hospitals Subject to the LTCH PPS

For the hospitals under the IPPS for which the fiscal intermediary applied alternative CCRs for discharges occurring on or after August 8, 2003 (that were identified through the 3-step data analysis in section I.A. above), and, for discharges occurring in cost reporting periods beginning on or after October 1, 2003 for all other IPPS hospitals, fiscal intermediaries are to reconcile outlier payments at the time of cost report final settlement if:

- 1) Actual operating or capital CCRs are found to be plus or minus 10 percentage points from the CCRs used during that time period to make outlier payments, and
- 2) Total outlier payments in that cost reporting period exceed \$500,000.

Consistent with the June 9, 2003 **Federal Register** (68 FR 34504) in which we indicated that we intended to issue program instructions that would provide specific criteria for identifying those hospitals subject to reconciliation for the remainder of FY 2003 and for FY 2004, these criteria allow fiscal intermediaries to focus their limited resources on only those hospitals that appear to have disproportionately benefited from the time lag in updating their CCRs. Similarly, for hospitals subject to the LTCH PPS, for discharges occurring in cost reporting periods beginning on or after October 1, 2003, reconciliations should be made if:

- 1) Actual operating CCRs are found to be plus or minus 10 percentage points from the CCRs used during that cost reporting period to make outlier payments, and
- 2) **High cost outlier payments made under §412.525 and short stay outlier payments made under 42 CFR §412.529 combined** exceed \$500,000 in that cost reporting period. The return codes from the PRICER software may be used to identify the cases for which high cost outlier and/or short stay outlier payments were made in a cost reporting period.

These criteria for IPPS and LTCH PPS will be reevaluated periodically to assess whether they should be revised.

In the event that the criteria in this section III for IPPS hospitals and LTCHs do not identify additional hospitals that are being similarly overpaid (or underpaid) significantly for outliers, then, based on an analysis of the hospital's most recent cost and charge data that indicates that CCRs for those hospitals are significantly inaccurate, fiscal intermediaries also have the administrative discretion to reconcile cost reports of those additional IPPS hospitals and LTCHs. However, fiscal intermediaries must seek approval from their CMS Regional Office in the event they intend to reconcile outlier payments for an IPPS hospital or a LTCH that does not meet the above-specified criteria.

CMS will be issuing separate instructions detailing procedures to follow regarding this reconciliation process and the application of the adjustment for the time value of money.

IV. Notification to Hospitals under the IPPS and the LTCH PPS

Fiscal intermediaries are to notify a hospital whenever they make a change to its CCR. When a CCR is changed as a result of a tentative settlement or a final settlement, the change to the CCR should be included in the notice that is issued to each provider after a tentative or final settlement is completed.

The effective date of this PM is July 10, 2003.

The implementation date of this PM is July 10, 2003.

These instructions should be implemented within your current operating budget.

This PM may be discarded after July 1, 2004.

For IPPS Outlier Policy, contact Michael Treitel at 410-786-4552.

For LTCH PPS Outlier Policy, contact Michael Lefkowitz at 410-786-5316.