

HEALTH LAW

Update

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

CMS to Implement Changes to DRG Payments Over the Next Three Years

August 8, 2006

On August 1, 2006, the Centers for Medicare & Medicaid Services (“CMS”) issued the hospital inpatient prospective payment system (“IPPS”) final rule for fiscal year 2007 (the “Final Rule”), which contains the most significant IPPS reforms since IPPS began in 1983. Although CMS indicated in its proposed rule published on April 25, 2006 that certain of the reforms would be fully implemented in fiscal year 2007, CMS relaxed its implementation schedule in the Final Rule after receiving comments from various individuals and organizations, including members of Congress. The Final Rule now implements the reforms over a three year period.

Specifically, the rule will implement changes to the diagnostic related group (“DRG”) weighting system. Currently, the DRG weighting system is based on hospital charges. The new DRG weighting system will be based on hospital costs. According to CMS, this “reform will eliminate biases in the current system arising from the hospital practice of having list charges that disproportionately exceed costs for some services.” CMS is implementing the new DRG weighting system in accordance with the following three year transition schedule:

- During the first year of the transition, the relative weights will be based on a blend of 33 percent of the cost-based weights and 67 percent of the charge weights;
- During the second year of the transition, the relative weights will be based on a blend of 67 percent of the cost-based weights and 33 percent of the charge weights; and
- In the final year of the transition, the relative weights will be based on 100 percent of the cost-based weights.

In response to public comments, CMS refined the cost-based weighting system originally set forth by CMS in its proposed rule. For example, CMS expanded the number of distinct hospital departments from which the DRG relative weights will be calculated from 10 to 13. Other refinements include the addition of more hospital data in calculating the DRG relative weights and a method to account for the size of the hospital when evaluating the mark-up of charges over costs. Overall, CMS believes these

refinements will result in smaller changes to payment than the payment changes that would have resulted from the cost-based weighting system originally set forth in the proposed rule.

In addition to the new weighting system, the Final Rule also makes certain changes to the DRG classification system to account better for the severity of a patient's illness. In the Final Rule, CMS begins the transition to a severity-adjusted DRG system by adding 20 new DRGs to the current DRG system for fiscal year 2007. The Final Rule also sets forth CMS's plans to conduct an evaluation, along with obtaining public input, of alternative systems for more comprehensive severity adjustment. CMS intends to use this evaluation and input to make more comprehensive severity adjustments in the DRG system in fiscal year 2008.

The Final Rule will be published in the August 18, 2006 Federal Register. Please feel free to call any of the attorneys in our Healthcare Practice Area if you have any questions regarding the Final Rule or how it may impact your business.

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