understanding the financial impact of MS-DRGs

The changes to the Medicare inpatient prospective payment system (IPPS), announced by the Centers for Medicare and Medicaid Services (CMS) on Aug. 1, will redistribute payments among different types of inpatient cases. Overall payments are expected to increase by $3.8 billion in FY08, according to CMS. How—and how much—this redistribution will affect hospitals will depend not only on case mix and coding practices, but also on a provider’s ability to analyze its data and take proactive steps to prepare for the changes.

Assessing the Overall Impact

CMS’s move from diagnosis-related groups (DRGs) to Medicare severity DRGs (MS-DRGs) took effect on Oct. 1, changing the payment landscape for providers nationwide. At a high level, the impact can be estimated by looking at the change in a hospital’s case mix index when inpatient cases are reclassified from CMS DRG v24 (version 24—the previous DRG system) to the new MS-DRGs. (Changes to capital payments within the blended rates and market basket updates will also influence hospital payment and should be analyzed in addition to case mix changes.) These changes to the case mix index will result from new computations of the relative values for MS-DRGs, changes to the list of codes considered complication and comorbidities (CCs), and the newly introduced list of codes considered major complication and comorbidities (MCCs).

An example of one possible redistribution under MS-DRGs illustrates the full impact of MS-DRGs. A sample hospital’s Medicare discharges were compared using CMS DRG v24 and MS-DRGs.
The facility’s blended rate was computed using the FY08 rules and used to compute estimated Medicare payment. Payment under DRG v24 was $94,494,234 and estimated to be $94,640,653 under MS-DRGs, for an estimated overall financial impact of $145,581, or less than a 1 percent reduction in overall payment. Thus, the redistribution will affect this hospital, but not dramatically.

However, this is not the full story.

Drilling Down
The change in payment level will alter the relative profitability of individual service lines within the hospital. Drilling down into the hospital’s case mix, it becomes clear that the impact differs between medical and surgical cases. For medical cases, the estimated impact is $494,653 ($55,889,887 under DRG v24 versus $55,395,234 under MS-DRGs), a more substantial change in revenue. Although this potential revenue loss is offset by an estimated revenue gain of $349,072 for surgical cases, it is clear that some cases will receive greater payment in 2008 and some cases will receive less, thus affecting profitability.

So which clinical areas will experience revenue gains or losses? Using product lines to combine similar MS-DRGs, finance professionals can focus on specific areas that may experience a revenue change. For instance, in the analysis for the sample hospital, orthopedics, surgery, neurosurgery, CT surgery, and

### PRODUCT LINE IMPACT OF REDISTRIBUTION TO MS-DRGs, SAMPLE HOSPITAL

- **Orthopedics**: $390,941,491
- **Surgery**: $38,750,347
- **Neurosurgery**: $55,395,234
- **CT Surgery**: $100,000
- **Ophthalmology**: $0
- **Behavioral**: $0
- **Neurology**: $0
- **Vascular**: $0
- **Renal**: $0
- **Pulmonary**: $0
- **Medicine**: $0
- **Cardiology**: $0

By using product lines to combine similar MS-DRGs, finance professionals can determine which clinical areas will experience revenue gains or losses—and develop action plans to manage changes in revenue.
ophthalmology were all estimated to receive greater payment (i.e., the case mix in these areas will increase in 2008). However, behavioral medicine, neurology, women’s health, vascular, renal, pulmonary, medicine, and cardiology services were all estimated to receive less payment. Cardiology is expected to experience the greatest impact—almost $700,000. The net effect of redistribution within these product lines is a lower case mix index and, therefore, lower estimated payments in 2008.

The Bottom Line
Hospitals should continue to analyze the data within product lines to identify trends, whether by physician or by specific MS-DRG. Action plans can then be developed to proactively manage the changes in revenue to improve the overall financial health of the hospital.

The bottom line: To fully grasp the impact of the redistribution of payment resulting from the CMS changes to the Medicare IPPS, hospitals—even hospitals whose overall payments will remain relatively unchanged—should look beyond the overall impact of MS-DRGs and seek to determine which areas of the hospital will be most affected. With thoughtful analysis followed by appropriate action to ensure complete and accurate documentation and coding, hospitals will be well-prepared to succeed under the new payment system.

K.C. Mitchell, PhD, is analytics and automation services manager, 3M Consulting Services, 3M Health Information Systems, Inc., Atlanta (kcmitchell@mmm.com).