

Independent Hospital Pricing Authority

# Assessment of Legitimate and Unavoidable Cost Variations Framework

April 2021



IHPA

## Assessment of Legitimate and Unavoidable Cost Variations Framework – Version 3.0 April 2021

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# Acronyms and abbreviations

<b>CGC</b>	Commonwealth Grants Commission
<b>IHPA</b>	Independent Hospital Pricing Authority
<b>NEP</b>	National efficient price
<b>Pricing Framework</b>	<i>Pricing Framework for Australian Public Hospital Services</i>
<b>The Act</b>	<i>National Health Reform Act 2011 (Cwlth)</i>
<b>The Addendum</b>	Addendum to the National Health Reform Agreement 2020–25
<b>The Framework</b>	Assessment of Legitimate and Unavoidable Cost Variations Framework

# Definitions

<b>Activity based funding</b>	<p>Refers to a system for funding public hospital services provided to individual patients using national classifications, cost weights and nationally efficient prices developed by the Independent Hospital Pricing Authority (IHPA), as outlined in the Addendum to the National Health Reform Agreement 2020–25 (the Addendum).</p> <p>An activity based funding activity may take the form of a separation, presentation or service event.</p>
<b>Patient complexity</b>	<p>Patient related factors which impact the cost of providing public hospital services (such as Indigenous status), which are not covered in the classification.</p>
<b>Public hospital services</b>	<p>From 1 July 2013, the scope of public hospital services eligible for Commonwealth funding will be<sup>1,2</sup>:</p> <ul style="list-style-type: none"> <li>• All admitted programs, including hospital in the home programs</li> <li>• All emergency department services</li> <li>• Non-admitted services that meet the criteria for inclusion in the IHPA General List.</li> </ul>
<b>Pricing Authority</b>	<p>The governing body of IHPA established under the <i>National Health Reform Act 2011</i> (Cwlth).</p>
<b>Legitimate and unavoidable costs</b>	<p>Costs associated with providing clinically appropriate public hospital services, where there are legitimate differences between patient and provider groups, and which are unavoidable.</p>

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<sup>1</sup> In August 2011, Governments agreed to be jointly responsible for funding growth in ‘public hospital services’. As there is no standard definition or listing of public hospital services, Governments gave IHPA the task of deciding which services will be ruled ‘in scope’ as public hospital services, and so eligible for Commonwealth funding under the Addendum.

<sup>2</sup> With regards to IHPA’s role in defining the scope of public hospital services, refer to the Addendum clauses A16–A32.

# 1. Executive summary

## 1.1 Background

Section 131(1)(d) of the *National Health Reform Act 2011* (Cwlth) (the Act), allows the Independent Hospital Pricing Authority (IHPA) to determine adjustments to the national efficient price (NEP) to reflect legitimate and unavoidable variations in the costs of delivering health care services. Additionally, clause A47 of the Addendum to the National Health Reform Agreement 2020–25 (the Addendum) specifies that when making this assessment, IHPA must have regard to legitimate and unavoidable variations in wage costs and other inputs which affect the costs of service delivery. This includes:

- a) hospital type and size;
- b) hospital location, including regional and remote status; and
- c) patient complexity, including Indigenous status.

IHPA reassures all stakeholders that the annual review of price adjustments will include both existing adjustments and potential adjustments. That is, the adjustments to the NEP that have been previously approved may not be included on an ongoing basis. IHPA undertakes a program of ongoing validation, testing and refinement of any price adjustments that it introduces.

IHPA will adopt the Pricing Guidelines to guide its decision-making, where it is required to exercise policy judgement in undertaking its legislated functions.

A jurisdiction may request IHPA to consider any legitimate and unavoidable costs in the delivery of public hospital services, based on a detailed submission and supporting evidence.

## 1.2 Purpose

The purpose of the Assessment of Legitimate and Unavoidable Cost Variations Framework (the Framework) is to assist jurisdictions in making submissions to IHPA on these issues, to lay out the process which IHPA will follow in assessing any such submission, to determine adjustments to the NEP.

## 1.3 Review

The Pricing Authority and Chief Executive Officer of IHPA will review this Framework, including associated documentation, annually or as required.

The Framework was last reviewed in April 2021.

# 2. What is a legitimate and unavoidable cost?

## 2.1 Overview

A number of factors may affect the cost of public hospital service delivery. This includes for instance:

- a) hospital type and size;
- b) hospital location, including regional and remote status; and
- c) patient complexity, such as Indigenous status, which is not captured by the classification system.

There are other factors which may lead to 'legitimate and unavoidable' variations in costs, many of which have already been recognised by the Commonwealth Grants Commission (CGC) in its review of the factors which impact on the costs of service provision. Clause A48 of the Addendum specifically directs IHPA not to be all encompassing in its consideration of suitable adjustments to the NEP:

“While these adjustments to the national efficient price should provide a relevant price signal to States and Local Hospital Networks, the IHPA should not seek to duplicate the work of the Commonwealth Grants Commission in determining relativities”

In developing the *Pricing Framework for Australian Public Hospital Services* (the Pricing Framework) and adjustments to account for legitimate and unavoidable costs, IHPA will consult with the CGC to ensure the proposed adjustments do not duplicate existing grants.

Adjustments to the NEP are made at the patient level and applied nationally to avoid jurisdictional-specific loadings wherever possible.

## 2.2 Eligibility criteria

Jurisdictions must outline in the written request the evidence or best available information to support the following criteria:

1. That a difference in costs (between patients or provider groups) can legitimately be demonstrated
2. Those differences in costs are unavoidable.

In addressing these criteria, jurisdictions should note the following:

- The mere demonstration of cost differences is not sufficient to support legitimate and unavoidable cost variations. Submissions need to identify the contributing factors to any unavoidable cost difference, and where more than one exists, they must support the relative contribution of each factor to the overall cost variation
- The difference in costs has not been created by the service itself, nor is the difference attributable to state or territory policies

- There is a clear differentiation between costs relating to inefficiency and costs relating to providing a necessary service based on clinical need
- An adjustment to the NEP to reflect legitimate and unavoidable variations in the costs of delivering health care services will be based on evidence that there are systemic factors which can be categorised across the nation (per Stage 1a of the assessment process), for example, factors based on hospital location.



## 3. Assessment process

Requests by jurisdictions for IHPA to assess legitimate and unavoidable costs, and potential future adjustments to the NEP, must be received by IHPA by no later than 31 May of that same year. Potential adjustments may also be proposed in response to the annual Pricing Framework consultation. Any agreed adjustments to the NEP will be included in the Pricing Framework for the next financial year.

The key stages in the IHPA assessment process are outlined below.

**Table 1: Overview of assessment process**

Stage	Process Details
<b>Stage 1: Request for assessment</b>	(1a) Jurisdiction determines that it meets the criteria for assessment
	(1b) Jurisdiction requests an assessment by IHPA no later than 31 May in a given year
<b>Stage 2: Assessment</b>	(2a) IHPA reviews the request and evidence provided
	(2b) IHPA provides notification of the request to all jurisdictions and invites written submissions to be made to IHPA within 28 days
	(2c) IHPA undertakes the assessment. Further information may be requested from jurisdictions with a 14-day consultation period
<b>Stage 3: Draft decision</b>	(3a) IHPA determines the decision
	(3b) IHPA drafts the decision and provides to the jurisdictions for a 14-day consultation period
	(3c) IHPA reviews the written comments by the jurisdictions with regard to the draft decision. If further clarifications are needed they will be sought within 7 days
<b>Stage 4: Final decision</b>	(4a) IHPA drafts the final decision and provides to the jurisdictions
	(4b) IHPA refines the Pricing Framework (if applicable)

### Stage 1: Request for assessment

#### (1a) Jurisdiction determines that it meets the criteria for assessment

A jurisdiction may request IHPA consider legitimate and unavoidable variations as per the eligibility criteria outlined in Chapter 2.

### **(1b) Jurisdiction requests an assessment by IHPA**

The request must be in writing and be accompanied by a written submission to support the criteria outlined in [Section 2.2 \(Eligibility Criteria\)](#).

Relevant information, data and documents to enable IHPA to understand the issues involved must be provided by the jurisdiction in support of the request. This should include any analyses undertaken based on available data, including the National Hospital Cost Data Collection.

To assist jurisdictions in preparing a written request, IHPA has developed guidance on what to include in the written submission (see [Appendix A](#)).

## **Stage 2: Assessment**

### **(2a) IHPA reviews the request and evidence provided**

IHPA will assess the submission against the criteria. IHPA will only proceed to undertake the assessment where the jurisdiction outlines in the request the evidence or best available information to support the criteria.

If IHPA is not satisfied that these criteria have been met, the request will be referred back to the jurisdiction:

- explaining that insufficient information has been provided to enable IHPA to undertake an assessment of whether the costs are legitimate and unavoidable
- seeking additional information to enable IHPA to make this assessment.

No further action will be taken by IHPA in relation to the request until the requesting jurisdiction provides the additional information.

### **(2b) IHPA provides notification of the request to all jurisdictions**

As the request for assessment may impact other jurisdictions, IHPA will provide all the jurisdictions (in writing):

- the request for assessment received from the jurisdiction, including a copy of the written submission that accompanied the request
- an invitation to make a written submission to IHPA within 28 days, including supporting evidence to assist the assessment at the national level.

### **(2c) IHPA undertakes the assessment**

In undertaking the assessment IHPA will assess the submissions received from all jurisdictions. Where required, IHPA will:

- request additional evidence from jurisdictions (for example, data, information, documents or agreements) to clarify facts and ambiguities in the assessment
- consult further with jurisdictions
- seek expert input/advice.

To support the timeliness of the investigation, jurisdictions should provide additional information within 14 days after receiving the written request.

In undertaking its assessment, IHPA will assess the proposal to:

1. Determine the implications at the national level<sup>3</sup>. This analysis will include, but not be limited to:
  - differences in costs between patients or provider groups
  - differences in costs relating to inefficiency and costs relating to providing a necessary service that is inherently inefficient
  - empirical differences in the cost of providing services as a measure of whether there are legitimate and unavoidable variations in the costs of service delivery that may warrant an adjustment to the NEP.
2. Adopt the Pricing Guidelines outlined in the Pricing Framework, to guide its decision-making and to ensure transparency and accountability in how it undertakes its work.
3. Have regard to materiality guidelines included in the IHPA *Assessing Materiality of Changes Proposed to the National Pricing Model Policy*.
4. Confirm that it does not duplicate the work of the CGC in determining relativities, as outlined in clause A48 of the Addendum.

### Stage 3: Draft decision

#### (3a) IHPA determines the decision

IHPA will only determine that adjustments should be made to the NEP to reflect legitimate and unavoidable costs in the delivery of public hospital services where, at a national level:

- there is demonstrable evidence to support the costs
- the cost differences cannot be said to be created by affected providers
- when assessing the data for identification of cost differences, all patient-related factors are considered and addressed before any provider-related factors
- there is alignment with the Pricing Guidelines
- it does not duplicate the work of the CGC in determining relativities.

#### (3b) IHPA drafts the decision and provides to the jurisdictions

Following the assessment process, IHPA will:

- prepare a draft decision and obtain endorsement from the Pricing Authority
- provide the draft decision to all jurisdictions
- invite jurisdictions to provide IHPA written comments on the draft decision within 14 days of receiving them.

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<sup>3</sup> Where the data does not produce reliable measures of cost differences, IHPA will undertake analysis based on the best available information. This may occur in some cases, such as where the:

- patient level data is not available (for example, outpatient activity)
- attribution of costs to the relevant patient groups will not be accurate (for example, costs of hospital Aboriginal Liaison Officers may not be attributed to Indigenous patients, in which case the costs of those patients may be underestimated).

Neither the Act nor the Addendum prescribe any timeframes in relation to IHPA conducting the assessment. However, subject to adequate evidence to support IHPA undertaking a timely investigation, it is expected that IHPA will be able to provide the draft decision to the jurisdiction within three months of receiving the request.

The draft decision will include the following:

- summary of the request
- overview of the evidence examined and analysis undertaken
- any limitations to the scope of the assessment
- IHPA's decision as a result of the assessment
- reasons supporting the decision.

### **(3c) IHPA reviews the written comments by the jurisdictions with regards to the draft decision**

IHPA will review the comments received from the jurisdiction(s) on the draft decision.

IHPA may seek further explanation or clarification of issues or statements that appear in the submissions. IHPA will request this in writing from the relevant jurisdiction(s). To support the timeliness of the final decision, this response will be requested to be provided within seven days after receiving the request for clarification.

## **Stage 4: Final decision**

### **(4a) IHPA drafts the final decision and provides to the jurisdiction**

IHPA prepares a final decision and obtains endorsement from the Pricing Authority. The final decision will be provided to all jurisdictions.

### **(4b) IHPA refines the Pricing Framework (if applicable)**

Following the release of the final decision, IHPA will calculate and make adjustments to reflect legitimate and unavoidable costs in the delivery of public hospital services for the following NEP. Details of the policy decision will be outlined in the Pricing Framework.

# Appendix A: Guidance on evidence to be included in the request for assessment

To assist jurisdictions in preparing a request for assessment of legitimate and unavoidable costs, IHPA has developed guidance on the evidence to be included in the written submission. This is outlined in the table below.

**Table 1: Guidance on evidence to be included to accompany the written request**

Topic	Evidence
Contact details	Key person contact details – these details will be used to seek clarification on any matters relating to the request.
Request particulars	<p>Evidence that a difference in costs (between patients or provider groups) can legitimately be demonstrated and those differences in costs are unavoidable, such as due to:</p> <ul style="list-style-type: none"> <li>- hospital type and size</li> <li>- hospital-related and environmental factors that place constraints on the extent to which hospitals can reduce their costs (for example, hospital location, including regional and remote status)</li> <li>- patient complexity, including Indigenous status, which is not captured by the classification system.</li> </ul> <p>Relevant background/contextual information to support IHPA in understanding the issues involved.</p> <p>Details of any risks identified.</p>
Supporting documentation	<p>Evidence which may support IHPA in its assessment (for example, data, information, documents or agreements).</p> <p>Analysis undertaken based on available data, including the National Hospital Cost Data Collection.</p>

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