IHPA

Independent Hospital Pricing Authority

Understanding the NEP and NEC 2016-17

March 2016

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1. Introduction

The Independent Hospital Pricing Authority's (IHPA) key role is to determine the annual National Efficient Price (NEP) and National Efficient Cost (NEC) for Australian public hospital services. IHPA publishes the NEP and NEC Determination every year.

The NEP underpins Activity Based Funding (ABF) across Australia for public hospital services. ABF is a way of funding hospitals whereby they get paid for the number and mix of patients they treat. ABF should improve the value of the public investment in hospital care and ensure a sustainable and efficient network of public hospital services.

In order to make these Determinations IHPA develops and publishes the annual *Pricing Framework for Australian Public Hospital Services*. This document is crucial as it outlines the principles and policies adopted by IHPA to determine the NEP and the NEC for each financial year.

IHPA consults with all stakeholders, including state and territory governments, the Commonwealth Government and the general public, prior to finalising the Pricing Framework each year.

The Pricing Framework is released prior to the NEP and NEC Determinations to provide transparency and accountability by making available the key principles and policies adopted by IHPA to inform the NEP and NEC Determinations.

About the National Efficient Price (NEP)

The NEP is based on the average cost of an admitted acute episode of care provided in public hospitals during a financial year. Each episode of patient care is allocated a National Weighted Activity Unit (NWAU).

The NWAU is a measure of hospital activity expressed as a common unit, against which the NEP is paid. It is a point of relativity for the pricing of hospital services, which are weighted for clinical complexity. The 'average' hospital service is worth one NWAU. More intensive and expensive activities are worth multiple NWAUs, and simpler and less expensive activities are worth fractions of an NWAU.

The price of each public hospital service is calculated by multiplying the NWAU allocated to that service by the NEP.

For example:

- A tonsillectomy has a weight of 0.7131 NWAU which equates to $3,482.
- A coronary bypass (minor complexity) has a weight of 5.2430 NWAU which equates to $25,602.
- A hip replacement (minor complexity) has a weight of 4.0965 NWAU which equates to $20,003.

The NEP has two key purposes:

1. To determine of the amount of Commonwealth Government funding for public hospital services.

2. To provide a price signal or benchmark about the efficient cost of providing public hospital services.

Each NEP Determination includes the scope of public hospital services eligible for Commonwealth Government funding on an activity basis (detailed in a document released by IHPA called the 'General List'). It also includes adjustments to the price to reflect legitimate and unavoidable variations in the cost of delivering health care services, such as location of patient residence and patient complexity.

The NEP is used by jurisdictions as an independent benchmarking tool to measure the efficiency of public hospital services in their state or territories. For instance, it is possible to compare the cost of the hip replacement in two different hospitals which may assist jurisdictions to identify best practice and make funding decisions.

About the National Efficient Cost (NEC)

The NEC is used when activity levels are not suitable for funding based on activity such as small rural hospitals. In these cases services are funded by a block allocation based on size and location. This type of funding applies to approximately 380 small rural hospitals.

The NEC also applies to public hospital services or functions that are not yet able to be described in terms of 'activity' such as teaching, training and research.

Some of these hospitals and services may operate with a mix of block grant and ABF.

The NEC Determination provides a set dollar amount that represents the average cost of block funded hospitals across Australia. Hospitals are assigned to a size-locality grouping and mean expenditure is calculated for groupings.

IHPA works closely with a Small Rural Hospital Working Group which includes representatives from states and territories, small rural hospitals and peak healthcare bodies and associations. The working group provides vital guidance and advice to IHPA about setting an effective cost for block funding.

The key difference between the NEP and the NEC is that in relation to the NEC the states and territories manage the total block funding amount provided to hospitals. This is determined through service level agreements that are made between the states and territories and the Local Hospital Networks.

2. Summary of key changes

Based on the principles in the *Pricing Framework for Australian Public Hospital Services 2016-17*, IHPA has determined the NEP and NEC for 2016-17.

National Efficient Price 2016-17

The NEP for 2016-17 is $4,883 per NWAU.

The NEP has been impacted by a number of methodological improvements. The improvements with material impacts on the NEP for 2016-17 are as follows:

Private patients

IHPA uses data contained in the *National Hospital Cost Data Collection* (NHCDC) to determine the cost of hospital services. Analysis of the NHCDC suggests there are variations in the way hospitals account for private patient costs. Some hospitals appear to include private patient medical costs in the NHCDC, whilst others have other ways of accounting for the costs leading to an under-attribution of total medical costs across all patients.

IHPA accounts for these missing private patient medical costs through a correction factor which inflates NHCDC costs nationally. For NEP16, IHPA has refined its private patient correction factor by incorporating jurisdictional advice on the costing practices of their hospitals. This more targeted approach ensures that the National Pricing Model better reflects the actual costs of delivering public hospital care to public and private patients.

Posthumous organ and tissue donation

IHPA has not previously priced posthumous organ donation activity on the understanding that these costs were already funded by the Commonwealth through the Organ and Tissue Authority (OTA). However on further investigation OTA advised that while it contributes to costs in preparing a patient for organ donation, it does not cover the costs of organ retrieval or costs incurred thereafter.

IHPA has worked with jurisdictions to identify organ donation costs and has priced organ donation activity for NEP16. This improves coverage of ABF services and assists hospitals in accounting for all costs incurred in treating these patients.

IHPA will continue to work with jurisdictions and the OTA to determine a nationally consistent approach to reporting posthumous organ donation costs through the Australian Hospital Patient Costing Standards that will ensure the costs of these services are fully recognised in future years.

Emergency care age adjustment

After analysing data from across jurisdictions, IHPA discovered that a patient's age had an impact on the cost of providing emergency care services and that these costs are not adequately accounted for in the Urgency Related Groups classification system.

Therefore IHPA has introduced an age related adjustment for Emergency Department and Emergency Service patients in NEP16 to better account for the impact of age on patient costs.

Indexation of cost data

The cost data used to develop NEP16 is sourced from the NHCDC for 2013-14. To account for the three year time lag between the costing data and the price, IHPA indexes the cost data using a pre-determined indexation methodology. IHPA has reviewed the indexation methodology in preparation for determining NEP16, and has decided that its approach to indexation is appropriate.

The Pricing Authority has recalculated NEP15 using more up to date cost data than was available when NEP15 was initially calculated. This is allowed for in the National Health Reform Agreement (Clause A40).

The back-cast NEP15 shows an increase of 2% between NEP15 and NEP16 which is the basis for Commonwealth growth funding for 2016-17.

NEP15	Back-cast NEP15	NEP16
$4,971	$4,783	$4,883

National Efficient Cost 2016-17

The NEC for 2016-17 is $5.020 million.

The NEC16 has been impacted by a number of methodological improvements as well as improved data robustness. These improvements have been achieved through the collaborative efforts of the Small Rural Hospital Working Group that has assisted IHPA with constructive advice and expert guidance.

Commonwealth funding for block funded hospitals is based on growth between NEC15 and NEC16. In order to calculate this growth, a back-cast NEC15 has been calculated to place it on the same basis as NEC16. The back-cast NEC15 figure is $4.826 million, indicating growth of 4% from NEC15 to NEC16.

3. More information

For more information about IHPA, Activity Based Funding or the NEP and NEC Determinations, please visit www.ihpa.gov.au or contact enquiries.ihpa@ihpa.gov.au.