Adverse impact notification sent to Joint Commission on Administrative Rules, House Committee on Appropriations, and Senate Committee on Finance (COV § 2.2-4007.04.C): Yes ☒ Not Needed ☐

If/when this economic impact analysis (EIA) is published in the *Virginia Register of Regulations*, notification will be sent to each member of the General Assembly (COV § 2.2-4007.04.B).

Virginia Department of Planning and Budget

Economic Impact Analysis

12 VAC 30-70 Methods and Standards for Establishing Payment Rates – Inpatient Hospital Services
Department of Medical Assistance Services
Town Hall Action/Stage: 4324/7161
July 14, 2015

Summary of the Proposed Amendments to Regulation

Pursuant to the 2014 Special Session I Acts of the Assembly, Chapter 2, Item 301 VVV, the Department of Medical Assistance Services (DMAS) proposes to replace the All Patient Diagnosis-Related Group classification system with the All Patient Refined Diagnosis-Related Group system for inpatient hospital operating reimbursement. The proposed payment methodology has been in effect since October 1, 2014.

Result of Analysis

The benefits likely exceed the costs for all proposed changes.

Estimated Economic Impact

Prior to October 1, 2014, Virginia's Medicaid reimbursement methodology for inpatient hospital operating costs was based on the All Patient Diagnosis-Related Group classification system. The Diagnosis Related Groups (DRGs) are a patient classification scheme which provides a means of relating the type of patients a hospital treats (i.e., its case mix) to the costs incurred by the hospital. There are currently three major versions of the DRGs in use in the United States: basic DRGs, All Patient DRGs, and All Patient Refined DRGs. The basic DRGs are used by the Centers for Medicare and Medicaid Services (CMS) for hospital payment for Medicare beneficiaries. The All Patient DRGs (AP-DRGs) are an expansion of the basic DRGs

to be more representative of non-Medicare populations such as Medicaid or pediatric patients. The All Patient Refined DRGs (APR-DRG) system expands the AP-DRG structure by adding four levels of severity-of-illness and risk of mortality to create more refined and specific groupings.

The AP-DRG system utilized by Virginia Medicaid prior to October 1, 2014, assigned DRGs to submitted inpatient hospital claims (excluding inpatient acute psychiatric and rehabilitation hospital services) based on the diagnostic and procedure codes defined by the federal International Classification of Disease (ICD) version 9 classification system. However, CMS will implement an updated classification system, ICD-10, on October 1, 2015. With the implementation of the ICD-10 system, the current AP-DRG classification system will no longer be supported by existing software and will not be sustainable. As a result, pursuant to the 2014 Acts of the Assembly, Chapter 2, Item 301 VVV, DMAS implemented the APR-DRG system on October 1, 2014.

According to DMAS, the APR-DRG classification system is compatible with ICD-10 codes which will be implemented in October 2015 as well as ICD-9 codes currently in effect. Thus, the providers are not affected by the proposed new methodology as they will continue to submit the ICD-9 claims until ICD-10 claims go in effect in October 2015. While they will have to purchase new software to process ICD-10 claims in October 2015, those costs will be due to federal changes and cannot be attributed to these proposed changes.

The proposed methodology is beneficial in that it improves the accuracy of pricing and reimbursement by capturing differences in severity of illness and risk of mortality among patients and is compatible with either ICD-9 or ICD-10 claims.

The impact on aggregate reimbursement to all hospitals is estimated to be budget-neutral. In FY 2014, the total Medicaid reimbursement for inpatient hospital operating costs was approximately $401 million. However, the reimbursements to individual hospitals may increase or decrease under the new methodology. Based on FY 2014 data and assuming full implementation, 23 hospitals will receive $100,000 to $530,000 less, 34 hospitals will receive $0 to $99,999 less, 14 hospitals will receive $1 to $99,999 more, and 19 hospitals will receive $100,000 to $2.8 million more in their operating payments compared to payments under the old methodology. Pursuant to legislative mandate, DMAS is transitioning to APR-DRG by blending

AP-DRG and APR-DRG weights over a three year period. Using a three-year transition period, the weights will be based on the following blend of AP-DRG and APR-DRG weights: 50% APR-DRG and 50% AP-DRG in FY 2015, 75% APR-DRG and 25% AP-DRG in FY 2016, 100% APR-DRG in FY 2017.

Additionally, APR-DRG specific administrative implementation costs for DMAS are estimated to be $92,000. No significant administrative costs are expected on providers as no billing changes are required for the implementation of the new methodology.

Finally, DMAS also proposes to remove the 1,000 day threshold for exempting non-cost-reporting hospitals from filing cost reports. This change reflects the current DMAS policy and is not expected to have any significant economic impact other than clarifying the current regulations.

Businesses and Entities Affected

The proposed new methodology affects approximately 90 in-state and out-of-state hospitals currently. A few of the affected hospitals may be small and qualify as small businesses. While some of the 7 managed care organizations in Virginia may also change their provider reimbursement methodology for inpatient services following this change, this regulation does not require them to do so.

Localities Particularly Affected

The proposed changes apply throughout the Commonwealth.

Projected Impact on Employment

The proposed amendments are unlikely to significantly affect employment.

Effects on the Use and Value of Private Property

The new methodology will reduce reimbursement for 57 hospitals while increasing reimbursement for 33 hospitals. The asset values of the affected hospitals would be affected depending on the impact on their revenues.

Real Estate Development Costs

The proposed amendments are unlikely to significantly affect real estate development costs.

Small Businesses:

Definition

Pursuant to § 2.2-4007.04 of the Code of Virginia, small business is defined as "a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than $6 million."

Costs and Other Effects

Only a few of the 90 affected hospitals may be considered as small businesses. The costs and other effects on them would be the same as discussed above.

Alternative Method that Minimizes Adverse Impact

There is no known alternative that would minimize the adverse impact while accomplishing the same goals.

Adverse Impacts:

Businesses:

The proposed new payment methodology for inpatient hospital operating costs will reduce reimbursement for 57 hospitals.

Localities:

The proposed amendments will not adversely affect localities.

Other Entities:

The implementation of the proposed new methodology is expected to create an additional $92,000 in DMAS's administrative costs.

Legal Mandates

General: The Department of Planning and Budget has analyzed the economic impact of this proposed regulation in accordance with § 2.2-4007.04 of the Code of Virginia (Code) and Executive Order Number 17 (2014). Code § 2.2-4007.04 requires that such economic impact analyses determine the public benefits and costs of the proposed amendments. Further the report should include but not be limited to: (1) the projected number of businesses or other entities to whom the proposed regulatory action would apply, (2) the identity of any localities and types of businesses or other entities particularly affected, (3) the projected number of persons and employment positions to be affected, (4) the projected costs to affected businesses or entities to implement or comply with the regulation, and (5)the impact on the use and value of private property.

Adverse impacts: Pursuant to Code § 2.2-4007.04(C): In the event this economic impact analysis reveals that the proposed regulation would have an adverse economic impact on businesses or would impose a significant adverse economic impact on a locality, business, or entity particularly affected, the Department of Planning and

Budget shall advise the Joint Commission on Administrative Rules, the House Committee on Appropriations, and the Senate Committee on Finance within the 45-day period.

If the proposed regulatory action may have an adverse effect on small businesses, Code § 2.2-4007.04 requires that such economic impact analyses include: (1) an identification and estimate of the number of small businesses subject to the proposed regulation, (2) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the proposed regulation, including the type of professional skills necessary for preparing required reports and other documents, (3) a statement of the probable effect of the proposed regulation on affected small businesses, and (4) a description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation. Additionally, pursuant to Code § 2.2-4007.1, if there is a finding that a proposed regulation may have an adverse impact on small business, the Joint Commission on Administrative Rules shall be notified.

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