

Background

Since October 1, 1983, most hospitals have been paid under the hospital inpatient prospective payment system (PPS). However, certain types of specialty hospitals and units were excluded from PPS because the PPS diagnosis related groups do not accurately account for the resource costs for the types of patients treated in those facilities. Facilities originally excluded from PPS included rehabilitation, psychiatric, children's, cancer, and long term care hospitals, rehabilitation and psychiatric hospital distinct part units, and hospitals located outside the 50 states and Puerto Rico. These providers continued to be paid according to Section 1886(b) of the Social Security Act, as amended by Section 101 of the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982. They are frequently referred to as TEFRA facilities.

TEFRA facilities are paid on the basis of Medicare reasonable costs per case, limited by a hospital specific target amount per discharge. Each hospital has a separate payment limit or target amount which was calculated based on the hospital's cost per discharge in a base year. The base year target amount is adjusted annually by an update factor. For hospitals with cost above their target amount, the target acts as a payment limit. Hospitals whose costs are below their target amount are entitled to bonus payments equal to half of the difference between costs and the target amount, up to a maximum of five percent of the target amount. Medicare also makes additional payments to hospitals whose costs exceed their target amounts. For these hospitals, Medicare pays bonus payments equal to half of the amount by which the hospitals costs exceed the target amount up to 10 percent of the target amount. Hospitals that experience significant increase in patient acuity may also apply for additional Medicare exceptions payments.

The Medicare, Medicaid, and SCHIP, Balanced Budget Refinement Act of 1999 (BBRA)(Pub.L. 106-113), directed the development of a per diem PPS for inpatient psychiatric services furnished in hospitals and exempt units. Section 124 of the BBRA contains the complete statutory charge. The major requirements are a per diem payment amount, an "adequate patient classification system that reflects the differences in patient resource use and costs among such hospitals...", and budget neutrality in the first year of implementation. An adequate classification system would result in the appropriate targeting of greater prospective payments to providers treating more costly resource intensive patients using statistically objective criteria. The law also required that the Secretary submit a report to Congress describing the system, and directed implementation of the inpatient psychiatric PPS effective for cost reporting periods beginning on or after October 1, 2002.