

# Prospective Payment System:

Applying PPS to Commercial Business . . . Driving Changes  
in Reimbursement Practices to Reduce the Cost of Care

Ingenix  
Insights

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## Leveraging an Established Framework

Managed care organizations (MCOs) continue to seek new strategies to help contain rising health care costs, which consumed 16 percent of the nation's total economic output in 2004, the government's latest figures. One particularly effective strategy being implemented by payers is to leverage the established framework of Medicare's Prospective Payment System (PPS) to decrease the cost of care. This strategy enables payers to "pay as Medicare" pays, which can reduce out-of-network (OON) reimbursement by 60 percent or more, and cut in-network reimbursement costs by 25 percent.

### Time for a Transformative Approach

PPS provides payers with an effective tool to reduce the cost of facility contracting with providers. With PPS, prices are fixed in advance and payment is tied to the actual services delivered, instead of billed charges. PPS shifts the risk of treating patients to the provider through payment structures that encourage providers to deliver care efficiently and effectively. This is in contrast to the traditional cost containment strategies used by MCOs such as fee schedules and per diems which encourage over utilization or capitation, and which forces payers to shoulder an inappropriate level of financial risk. With PPS, MCOs only retain the risk of underwriting health care utilization for the population of enrollees. By sharing the risk, each group is accountable for that portion of risk that they can effectively manage.

Perhaps the biggest benefit is that PPS is an established methodology. Providers are familiar with using it for billing and reimbursement under Diagnosis-Related Groups (DRG) for inpatient care, and Ambulatory Payment Classifications (APCs) for outpatient care. PPS is used by many regulatory bodies, making it widely understood and accepted in the hospital community. These factors make PPS a highly-defensible strategy for the reimbursement of care.

PPS provides a mechanism to benchmark and implement successful in-network and OON reimbursement strategies against what providers are already accepting from Medicare. Modeling commercial payment strategies using Medicare experience enables payers to assess the impact of reimbursement strategies before implementation. In addition, this data enables payers to improve provider contract management and administration by streamlining unique provider contracts—which may number in the hundreds or thousands for a single MCO—into standardized models that accommodate the commercial requirements of payers.

Payers can realize immediate savings of up to 60 percent by using PPS to pay Medicare Advantage and managed Medicaid claims out-of-network. Under the Medicare Advantage program, payers are not required to pay any more for claims than the rates in effect for the traditional Medicare programs. Similar conditions apply to managed Medicaid plans.

PPS is also ideal for paying commercial in-network and OON claims. With commercial OON claims—which can exceed 20 percent of the total claims that a payer receives, by volume—Ingenix research shows that payers can realize savings of 60 percent or greater by paying OON claims using PPS. Commercial inpatient claims easily adapt to using DRGs for non-Medicare populations, but far greater savings can be achieved by using APCs for commercial outpatient reimbursement. Ingenix research suggests that using APCs can save Medicare Advantage payers between \$300 and \$450 per out-of-network claim.

As more health plans implement pay-for-performance (P4P) initiatives and consumer-directed plans, PPS provides payers with the framework to control costs and make "apples-to-apples" cost comparisons. For example, PPS enables payers to vary rates by clinical area, so providers are paid more for high-quality clinical programs

and less for low-quality programs. For consumer-directed health plans, PPS provides the data needed for payers to give a direct answer to consumers' questions such as, "How much will hospital 'A' charge to replace my hip?"

## Critical Elements for Success

The benefits and opportunities of PPS are becoming increasingly clear to the health care industry and will continue to drive the adaptation of PPS to commercial populations. Both payers and providers alike can benefit from the more appropriate and efficient alignment of risk that PPS brings, yet payers will need to incorporate the following solutions for their efforts to be successful.

### **INTEGRATE PPS INTO**

#### **CLAIMS PROCESSING APPLICATIONS**

Payers need their core claims applications to be integrated with the tools to accurately pay out-of-network claims, verify bills from providers, and effectively negotiate PPS contracts. This is achieved with an embeddable software library that handles claims pricing, analysis and risk management. Also within the library are the groupers, pricers, editors and other PPS tools that seamlessly integrate with claims processing systems to manage Federal (DRG and APC) prospective payment, as well as more than 30 state/payer-specific implementations.

#### **WEB-BASED ADMINISTRATION TOOLS**

A Web-based application extends the access to consistent and up-to-date regulatory and pricing content across the enterprise. Payers use this solution to validate payments, reconcile claims payment issues and to proactively model the impact of alternative payment schemes before implementation

#### **AUTOMATED REGULATORY CONTENT UPDATES**

The numerous regulatory updates associated with PPS can be difficult to manage, especially when utilizing multiple prospective payment systems. An enterprise content management system handles the complex rules and update processes for coding, compliance and reimbursement. Using Web-services technology, Medicare's frequent updates are cascaded automatically to both local and remote users in a timely manner, reducing IT workloads and allowing users to work with the most current information. With an

enterprise content management system, payers can support high-volume claims adjudication processes when using PPS for commercial business, as well automatically calculate the Medicare allowable for any of the 6000-plus facilities that bill Medicare.

## Health Plan Return on Investment

By successfully implementing PPS to handle commercial business reimbursement, some Ingenix payer customers have realized an average savings of \$4,880 per inpatient claim, which is a 42 percent savings on the paid amount, or a 57 percent savings on billed charges. On the outpatient side, payers can expect an average savings of \$416 per outpatient claim, which is a 72 percent savings on the paid amount, or a 79 percent savings on billed charges.

## Proof of Concept

Substantial savings can be realized quite quickly, even when PPS reimbursement is implemented only for specific business segments. For example, one large health plan that turned to Ingenix for a PPS solution realized an \$18.5 million savings in a single year by reimbursing OON Medicare Advantage claims with DRGs and APCs. This savings represented a 54 percent savings for the health plan, which has future plans to roll out PPS reimbursement for other business lines to achieve additional savings.

Other health plans using Ingenix PPS solutions have achieved 60 percent savings in their Medicare Advantage OON reimbursement costs. Beyond OON reimbursement savings, Ingenix customers are using PPS data to reduce costs by negotiating more favorable provider contracts. Medicare inpatient (DRG-based) payment rates are typically 30 to 35 percent of charges, which gives payers the data needed to negotiate greater discounts.

This data has been especially important for health plans negotiating provider contracts for outpatient encounters, which represent the fastest growing segment in health care expenses today, increasing more than 11 percent in 2004, according to America's Health Insurance Plans (AHIP). By using PPS reimbursement rates as a benchmark for outpatient charges, payers can determine the percentage that providers have inflated their charges for services.

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Ingenix research shows that PPS reimbursement for outpatient encounters is 31 to 42 percent less than providers charge payers under many traditional contracts. Once again this data gives payers the leverage needed to negotiate more favorable contracts.

## About the Company

More than 1,200 payers now look to Ingenix for solutions to their complex business challenges. By integrating a diverse suite of products and services, Ingenix helps its clients increase revenue, manage medical costs, and simplify complex administrative and financial processes with powerful data, software, consulting, and outsourcing solutions. Consistent capital investment, stability of resources, and continual innovation have made Ingenix one of the largest and fastest-growing U.S. health care information companies.

## About the Authors

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