

Independent Hospital Pricing Authority

Understanding the NEP and NEC 2019-20

March 2019



IHPA

Understanding the NEP and NEC 2019-20 – March 2019

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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 Determinations every year.

The NEP underpins Activity Based Funding (ABF) across Australia for public hospital services. ABF is a way of funding hospitals whereby they are paid for the number and mix of patients they treat. ABF is intended to 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 0.7019 NWAU which equates to \$3,604.
- A coronary bypass (minor complexity) has a weight of 5.2449 NWAU which equates to \$26,927.
- A hip replacement (minor complexity) has a weight of 3.8794 NWAU which equates to \$19,917.

The NEP has two key purposes:

1. To determine 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 'the General List of In-Scope Public Hospitals'. It also includes loadings to the price ('adjustments') to reflect legitimate and unavoidable variations in the cost of delivering health care services, such as location of patient residence and patient complexity.

Approximately 460 public hospitals nationwide, including all of the large metropolitan hospitals, receive funding based on their activity levels.

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, location and the type of services they provide. This type of funding applies to approximately 370 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 funding 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-type 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.

Summary of key changes

Based on the principles in the *Pricing Framework for Australian Public Hospital Services 2019-20*, IHPA has determined the NEP and NEC for 2019-20.

National Efficient Price 2019-20

The NEP for 2019-20 is \$5,134 per NWAU.

Some minor methodological improvements have been made to the NEP for 2019-20.

IHPA has extended a number of adjustments that previously only applied to patients receiving admitted acute care to include patients receiving subacute, emergency department and non-admitted services. These include the adjustments for patient residential remoteness, patient treatment remoteness, radiotherapy and dialysis.

In 2019-20 IHPA will be undertaking a fundamental review of the national pricing model that underpins the NEP to ensure that the assumptions and methodology remain robust and relevant. The fundamental review will look at areas including remoteness classifications, indexation, back-casting, price weights and emerging technology.

Back-casting

As with previous years, the Pricing Authority has recalculated ('back-cast') NEP18 to incorporate the most up-to-date cost data and to take account of methodological changes introduced in NEP19 which impact on the ability to compare the NEP between years. IHPA is required to back-cast the previous year's NEP under Clause A40 of the National Health Reform Agreement.

Back-casting is important to ensure the calculation of Commonwealth funding is not adversely impacted by changes in the calculation of the NEP over years. Under the National Health Reform Agreement, the Commonwealth funds 45 per cent of the efficient growth in public hospital services which are funded on an activity basis, with a growth cap of 6.5 per cent a year.

The Pricing Authority has recalculated NEP18 using more up to date cost data than was available when NEP18 was initially calculated. This is allowed for in the National Health Reform Agreement (Clause A40).

The back-cast NEP18 shows an increase of 1.8% between NEP18 and NEP19, which is the basis for Commonwealth growth funding for 2019-20.

NEP18	Back-cast NEP18	NEP19
\$5,012	\$5,043	\$5,134

National Efficient Cost 2019-20

The NEC for 2019-20 is \$5.319 million.

The NEC cost model is determined using the in-scope activity converted to National Weighted Activity Units (NWAU), and expenditure data for identified hospitals to be block funded. Hospitals are assigned to a size-locality grouping and mean expenditure is calculated for groupings. IHPA removes the out-of-scope costs and indexes model costs to reflect efficient costs for the year of the NEC.

In addition, the NEC covers some services in public hospitals that do not meet the technical requirements for applying ABF. Usually this means that they cannot be counted and/or costed. For example, teaching, training and research and some non-admitted mental health services are instead provided a block funding amount.

Changes to the NEC Determination 2019-20 included the inclusion of block funding for non-admitted community child and adolescent mental health services as in-scope for public hospital funding from 2019-20.

IHPA recognises that service delivery models are not static and innovative models of care offer the potential to provide more efficient health services. The Pricing Guidelines outline the policy objectives to guide IHPA's work and reference fostering clinical innovation whereby the pricing of public hospital services respond in a timely way to introduce evidence-based, effective new technology and innovations in the models of care that improve patient outcomes.

With this in mind IHPA will continue to block fund patients on a trial basis in hospital avoidance programs that have been approved on the General of In-Scope Public Hospital Services.

Back-casting

Commonwealth funding for block funded hospitals is based on growth between NEC18 and NEC19. In order to calculate this growth, a back-cast NEC18 has been calculated to place it on the same basis as NEC19. The back-cast NEC18 figure is \$5.134 million, indicating growth of 3.6% from NEC18 to NEC19.

More information

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

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