

**Independent Hospital Pricing Authority**

Understanding the NEP and NEC 2017-18

March 2017

**1. Introduction**

The Independent Hospital Pricing Authority’s (IHPA) key role is to determine the annual [National Efficient Price (NEP)](https://www.ihpa.gov.au/what-we-do/national-efficient-price-determination)and [National Efficient Cost (NEC)](https://www.ihpa.gov.au/what-we-do/national-efficient-cost-determination)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*](https://www.ihpa.gov.au/what-we-do/pricing-framework)*.* 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.

Note: For this year only, the *Pricing Framework for Australian Public Hospital Services* will be released at the same time as the NEP and NEC Determinations. This revised timeframe reflects the detailed work IHPA has undertaken to identify and investigate a variety of options for incorporating safety and quality into the pricing of public hospital services for the NEP and NEC Determinations 2017-18.

**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 0.7080 NWAU which equates to $3,476.
* A coronary bypass (without complications) has a weight of 5.3034 NWAU which equates to $26,040.
* A hip replacement (without complications) has a weight of 4.1429 NWAU which equates to $20,342.

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 (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 2017-18*, IHPA has determined the NEP and NEC for 2017-18.

**National Efficient Price 2017-18**

The NEP for 2017-18 is $4,910 per NWAU.

The NEP has been impacted by a number of methodological improvements. The improvements with material impacts on the NEP for 2017-18 are as follows:

**Pricing and funding for safety and quality**

***Sentinel events***

IHPA has been directed by the Commonwealth Minister for Health to reduce funding to zero for public hospital episodes that include a sentinel (catastrophic) event that occurs on or after 1 July 2017, and apply this to all relevant episodes of care (all streams) in both ABF and block funded hospitals.

In implementing this approach, IHPA is to have regard to the Australian Commission on Safety and Quality in Health Care’s review of sentinel events and monitor and review the reporting of sentinel events by states and territories to ensure those events are adequately reported for the purposes of funding adjustments.

IHPA will work with jurisdictions to identify the most effective approach for states and territories to report sentinel events to IHPA and the Administrator of the National Health Funding Pool. IHPA will work with jurisdictions and the Administrator to determine the method of application in the national funding model.

IHPA is participating in the Australian Commission on Safety and Quality in Health Care’s review of sentinel events and will consider the outcomes of this review including any refinements that improve national consistency in the definition and reporting of sentinel events.

**Indexation of cost data**

The cost data used to develop NEP17 is sourced from the NHCDC for 2014-15. 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 NEP17, and has decided that its approach to indexation is appropriate.

**Back casting**

As with previous years, the Pricing Authority has recalculated (‘back-cast’) NEP16 to incorporate the most up-to-date cost data and to take account of methodological changes introduced in NEP16 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.

The Pricing Authority has recalculated NEP16 using more up to date cost data than was available when NEP16 was initially calculated. This is allowed for in the National Health Reform Agreement (Clause A40).

The back-cast NEP16 shows an increase of 1.6% between NEP16 and NEP17 which is the basis for Commonwealth growth funding for 2017-18.

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| **NEP16** | **Back-cast NEP16** | **NEP17** |
| $4,883 | $4,833 | $4,910 |

**National Efficient Cost 2016-17**

The NEC for 2017-18 is $5.406 million.

The NEC17 has seen a significant improvement in data robustness due to the results of IHPA’s collaborative work with the Australian Institute of Health and Welfare to review expenditure that is in-scope under the National Health Reform Agreement. These improvements have meant that IHPA is able to reflect the true cost of block funded hospitals better.

**Back casting**

Commonwealth funding for block funded hospitals is based on growth between NEC16 and NEC17. In order to calculate this growth, a back-cast NEC16 has been calculated to place it on the same basis as NEC17. The back-cast NEC16 figure is $5.163 million, indicating growth of 4.7% from NEC16 to NEC17.

**3. More information**

For more information about IHPA, Activity Based Funding or the NEP and NEC Determinations, please visit [www.ihpa.gov.au](http://www.ihpa.gov.au) or contact enquiries.ihpa@ihpa.gov.au.