

Independent Hospital Pricing Authority

# Understanding the NEP and NEC 2021–22

March 2021



IHPA

## Understanding the NEP and NEC 2021–22 – March 2021

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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](#) (the 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.

Ordinarily, the Pricing Framework is released prior to the NEP and NEC Determinations. However, this year the Pricing Framework has been released alongside the NEP and NEC Determinations. The revised timeline ensured that IHPA's consultation in developing the Pricing Framework considered the Addendum to the National Health Reform Agreement 2020–25 (the Addendum) and enabled IHPA to conduct early consultation on the emerging issues resulting from the COVID-19 pandemic.

## About the national efficient price

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 0.7383 NWAU which equates to \$4,132.
- A coronary bypass (minor complexity) has a weight of 5.3674 NWAU which equates to \$30,041.
- A hip replacement (minor complexity) has a weight of 3.5226 NWAU which equates to \$19,716.

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 as per the General List of In-Scope Public Hospital Services. 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 510 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**

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 funding and ABF.

The NEC Determination outlines an efficient cost of a small rural hospital, which is the sum of the fixed component and a variable cost component.

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 efficient cost of a small rural hospital.

# Summary of key changes

Based on the principles in the Pricing Framework for Australian Public Hospital Services 2021–22 (the Pricing Framework), IHPA has determined the national efficient price (NEP) and national efficient cost (NEC) for 2021–22.

## National efficient price 2021–22

The NEP for 2021–22 is \$5,597 per national weighted activity unit (NWAU).

A number of methodological improvements have been made to the NEP for 2021–22.

## Pricing for private patients in public hospitals

IHPA has incorporated an adjustment to achieve financial neutrality and payment parity between private patients and public patients treated in public hospitals, as required under the Addendum to the National Health Reform Agreement 2020–25 (the Addendum).

IHPA has developed the following definition of financial neutrality and payment parity in terms of revenue per NWAU 2021–22 (NWAU(21)) (excluding private patient adjustments):

*The sum of revenue a local hospital network (LHN) receives for public patient NWAU(21) (Commonwealth and state or territory activity based funding (ABF) payments) should be equal to payments made for a LHN service for private patient NWAU(21) (Commonwealth and state or territory ABF payments, insurer payments and Medicare Benefit Schedule payments).*

The methodology for implementation of the private patient neutrality clauses is through:

- a) The application of state based service adjustments for private patients published within this Determination
- b) Confirmation by states and territories of:
  - payments made to each LHN for private patients (aggregate)
  - payments made to each LHN for public patients (aggregate)
  - LHN private patient revenue targets.

The private funding neutrality adjustment will be calculated as an adjustment to the NEP for the purposes of calculating Commonwealth growth funding pertaining to private patients.

## Pricing and funding for safety and quality

The Addendum also requires IHPA to develop a pricing model for avoidable hospital readmissions, for implementation by 1 July 2021.

Unplanned hospital readmissions are a measure of potential issues with the quality, continuity and integration of care provided to patients during or subsequent to their initial hospital admission (the index admission). Reducing the number of avoidable hospital readmissions improves patient health outcomes and decreases avoidable demand for public hospital services.

The Australian Commission on Safety and Quality in Health Care (the Commission) has developed a definition and list of conditions considered to be avoidable hospital readmissions, which is available on the [Commission's website](#).

IHPA has developed a funding approach where the cost of the readmission episode will be deducted from the index episode, to apply where there is a readmission to any hospital within the same jurisdiction. The funding approach includes a comprehensive risk adjustment model, which accounts for the increased likelihood of some patients in experiencing an avoidable hospital readmission. The funding approach for readmissions has been incorporated into the NEP Determination 2021–22 (NEP21), and will complement existing measures by Australian governments to improve safety and quality in health care.

IHPA has also implemented improvements to the adjustment for hospital acquired complications (HACs), in line with Version 3.0 of the HAC list, which is available on the [Commission's website](#).

### Back-casting

As with previous years, the Pricing Authority has recalculated ('back-cast') the NEP Determination 2020–21 (NEP20) to incorporate the most up-to-date cost data and to take account of methodological changes introduced in NEP21 which impact on the ability to compare the NEP between years. IHPA is required to back-cast the previous year's NEP under clause A41 of the Addendum.

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 Addendum, 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 NEP20 using more up-to-date cost data than was available when NEP20 was initially calculated.

The back-cast NEP20 shows an increase of 2.7 per cent between NEP20 to NEP21, which is the basis for Commonwealth growth funding for 2021–22.

NEP20	Back-cast NEP20	NEP21
\$5,320	\$5,450	\$5,597

### National efficient cost 2021–22

The efficient cost of a small rural hospital is the sum of the fixed cost component and the variable cost component.

For 2021–22, the total modelled cost for block-funded hospitals up to 187 national weighed activity unit (NWAU) comprises a fixed cost of \$2.199 million and the variable cost of \$5,762 per NWAU. An additional loading of 30.2 per cent is applied for 'very remote' hospitals.

In addition, the NEC covers some services in public hospitals that do not meet the technical requirements for applying activity based funding. 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.

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 in the Pricing Framework 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 List of In-Scope Public Hospital Services.

The Addendum contains provisions around specific arrangements for high cost, highly specialised therapies recommended for delivery in public hospitals by the Medical Services Advisory Committee. This year, the NEC includes costs for the following high cost, highly specialised therapies recommended for delivery in public hospitals, based on advice received from the Commonwealth:

- Kymriah® – for the treatment of acute lymphoblastic leukaemia in children and young adults
- Kymriah® or Yescarta® – for the treatment of diffuse large B-cell lymphoma, primary mediastinal large B-cell lymphoma and transformed follicular lymphoma
- Qarziba® – for the treatment of high risk neuroblastoma
- Luxturna™ – for the treatment of inherited retinal disease.

### **Back-casting**

The back-cast NEC 2020–21 for the purpose of estimating Commonwealth growth funding estimated between 2020–21 and 2021–22 is the sum of the fixed component and the variable component.

The fixed component is determined as:

- \$2.120 million for hospitals with an annual NWAU(20) less than or equal to 187.
- \$2.120 million less 0.029 per cent per NWAU(20) for hospitals with an annual NWAU(20) greater than 187, with an additional loading of 30.2 per cent for 'very remote' hospitals.

The variable component of the efficient cost is determined as \$5,556 per NWAU(20) for hospitals with an annual NWAU(20) greater than 187.



# 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](mailto:enquiries.iHPA@iHPA.gov.au).

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