



**IHACPA**

# **Shadow Pricing Guidelines**

**June 2023**



## Shadow Pricing Guidelines – Version 3.0 June 2023

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# Acronyms and abbreviations

<b>ABF</b>	Activity based funding
<b>IHACPA</b>	Independent Health and Aged Care Pricing Authority
<b>JAC</b>	Jurisdictional Advisory Committee
<b>NEC</b>	National efficient cost
<b>NEP</b>	National efficient price
<b>NHRA</b>	National Health Reform Agreement
<b>NWAU</b>	National weighted activity unit
<b>TAC</b>	Technical Advisory Committee
<b>The Addendum</b>	Addendum to the National Health Reform Agreement 2020-25
<b>The NHR Act</b>	<i>National Health Reform Act 2011 (Cwlth)</i>
<b>The Administrator</b>	Administrator of the National Health Funding Pool
<b>The Guidelines</b>	<i>Shadow Pricing Guidelines</i>

# Definitions

<b>Activity based funding</b>	<p>Refers to a system for funding public hospital services provided to individual patients using national classifications, cost weights and nationally efficient prices developed by the Independent Health and Aged Care Pricing Authority (IHACPA), as outlined in the Addendum to the National Health Reform Agreement 2020–25.</p> <p>An activity based funding activity may take the form of a separation, presentation or service event.</p>
<b>Classification</b>	<p>Classifications are comprised of codes that provide clinically meaningful ways of creating a link between patients, their treatments and the costs and resources associated with providing these treatments. This allows hospital and health service provider output to be measured, which is valuable for informing policy decisions, benchmarking and funding of high quality and efficient health care services.</p>
<b>Costing methodology</b>	<p>Costing methodologies are ways to identify and allocate costs. Hospital patient costing focuses on the cost and mix of resources, including services or products, used to deliver patient care, in order to understand the total costs involved in treating a patient. Costing is used to inform the development of classification systems and provides valuable information for pricing purposes.</p>
<b>Costing study</b>	<p>IHACPA undertakes costing studies in areas where it has identified opportunities for improving the national pricing model or improving the understanding of costs of services. These areas include developing new classifications, major revisions to existing classifications and changes to costing methodologies.</p>
<b>National pricing model</b>	<p>The national pricing model is produced annually by IHACPA and defines the national efficient price, price weights and adjustments based on the cost and activity data from three years prior. For more detail, refer to the <a href="#">National Pricing Model Technical Specifications</a>.</p>
<b>Pricing Authority</b>	<p>The governing body of IHPA established under the <i>National Health Reform Act 2011</i> (Cwlth) (the NHR Act).</p>
<b>Shadow pricing</b>	<p>Shadow pricing is undertaken by IHACPA when developing new classifications or implementing significant changes to existing classifications. IHACPA undertakes shadow pricing with the publication of shadow price weights to ensure robust data collection and reporting to accurately model the financial and counting impact of changes on the national funding model and minimise the risk of incurring undesirable and inadvertent consequences.</p>

# 1. Executive summary

## 1.1 Background

The National Health Reform Agreement (NHRA), signed by all Australian governments in August 2011, specifies that the Independent Health and Aged Care Pricing Authority (IHACPA) is to develop, refine and maintain systems as necessary to determine the national efficient price (NEP) and national efficient cost (NEC), including classifications, costing methodologies and data collections.

The Addendum to the NHRA 2020–25 (the Addendum), signed in May 2020, further defines IHACPA's role in public hospital funding arrangements, in particular, the use of transitional arrangements such as shadow pricing and costing studies when developing new activity based funding (ABF) classification systems or costing methodologies.

IHACPA has developed guidelines on the principles, timeframes and evaluation methods associated with shadow pricing for new or changed ABF classification systems.

## 1.2 Provisions under the Addendum

The Addendum outlines provisions relating to the consultation processes IHACPA is required to undertake with all nine jurisdictions for proposed changes to the national funding model, with specific reference to processes for changes to classification systems and costing methodologies.

Clause A42 of the Addendum requires IHACPA to use transitional arrangements when developing new ABF classification systems or costing methodologies, including shadow pricing classification system changes and pricing based on a costing study, for two years or a period agreed with the Commonwealth and a majority of states and territories to ensure robust data collection and reporting to accurately model the financial and counting impact of changes on the national funding model.

Full extracts from the Addendum are provided at **Appendix A**.

## 1.3 Purpose

The purpose of the *Shadow Pricing Guidelines* (the Guidelines) is to provide guidance for the use of shadow pricing in the development and implementation of changes to classification systems. The Guidelines establish guiding principles for commencing shadow pricing, reporting requirements during the shadow pricing period and criteria for progression to pricing.

The Guidelines are to be applied in conjunction with the [National Pricing Model Consultation Policy](#), which outlines the principles and consultative processes associated with changes that materially impact the application of the national funding model, including timeframes for shadow pricing and the circumstances and exceptions where shadow pricing is required.

The Guidelines do not apply to IHACPA's functions pertaining to the provision of advice to the Commonwealth Government on aged care costing and pricing.

## **1.4 Review**

The Pricing Authority and Chief Executive Officer of IHACPA will review the Guidelines, including associated documentation, annually or as required.

The Guidelines were last reviewed in May 2023.

# 2. Assessing readiness for shadow pricing

## 2.1 Overview

Clause A42 of the Addendum requires IHACPA to use transitional arrangements when developing new ABF classification systems or costing methodologies, including shadow pricing classification system changes, for two years or a period agreed with the Commonwealth and a majority of states and territories.

As outlined in the *National Pricing Model Consultation Policy*, IHACPA will undertake shadow pricing for the introduction of new classifications and major structural changes to existing classifications.

IHACPA undertakes shadow pricing under these circumstances to ensure robust data collection and reporting to accurately model the financial and counting impact of changes on the national funding model and minimise the risk of incurring undesirable and inadvertent consequences.

## 2.2 Principles for commencing shadow pricing

The Addendum does not contain any stipulations requiring the agreement of jurisdictions to commence shadow pricing, however IHACPA will assess readiness for shadow pricing of a new classification or a major structural change to an existing classification in consultation with jurisdictions and other relevant stakeholders.

The following set of measures have been developed to guide the assessment of readiness for shadow pricing for a new or changed classification:

- The new or changed classification and pricing model have been developed in consultation with IHACPA's Clinical Advisory Committee, Jurisdictional Advisory Committee (JAC), Technical Advisory Committee (TAC) and relevant classification development working groups.
- The new or changed classification implements data elements that are currently captured or able to be captured in national data sets (National Minimum Data Set or National Best Endeavours Data Set) to enable pricing and funding reconciliation.
- The shadow pricing model is based on cost and activity data from an adequate number and range of establishments to provide appropriate coverage of the patient service category and be adequately representative of jurisdiction costs and activities.
- The available cost and activity data provides adequate coverage of all classification end-classes and there are clear and meaningful strategies to account for gaps in data.
- The shadow pricing model appropriately accounts for outliers and variation in the underlying data to facilitate pricing model and year-on-year stability.
- The shadow pricing model appropriately accounts for risk and legitimate and unavoidable cost variations, with consideration given to clinical significance, statistical performance and model complexity.



- In progression to shadow pricing, IHACPA will make every effort to minimise undue administrative, financial or operational burdens on jurisdictions (such as dual data collection).

In addition to assessment against the above measures for readiness for shadow pricing, IHACPA will develop and provide states and territories with national weighted activity unit (NWAU) calculators for shadow price weights. States and territories will be able to monitor the impacts of shadow price weights on local systems, to provide feedback to IHACPA during the shadow period.

This will facilitate consideration of potential medium and long term impacts on the national pricing model and assist in ensuring that the shadow pricing model is fit-for-purpose.

## 2.3 Consultation process

IHACPA will consult with jurisdictions through JAC and TAC in assessing readiness for shadow pricing. Proposals to commence shadow pricing will be tabled through JAC and TAC, where IHACPA will provide the jurisdictional representatives with updates on classification development, updates on shadow pricing model development, relevant reports and analysis, and IHACPA's rationale to shadow price.

Following consultation through JAC and TAC, the feedback from jurisdictions, any additional analysis and the proposal to shadow price will be provided to the Pricing Authority for consideration. Where the proposal is not supported by jurisdictional representatives through JAC, however is approved by the Pricing Authority for progression to shadow pricing, IHACPA will provide the Pricing Authority's rationale to JAC Members.

## 2.4 Timeframes for commencing shadow pricing

As outlined in the *National Pricing Model Consultation Policy*, the starting point for the two-year shadow period will be the commencement of the financial year immediately following the Pricing Authority's decision to commence shadow pricing or any other date agreed between IHACPA, the Commonwealth and a majority of states and territories.

In alignment with the annual NEP and NEC development cycle, IHACPA will communicate its intent to shadow price to broader stakeholders through its annual Consultation Paper on the Pricing Framework for Australian Public Hospital Services and communicate decisions on shadow pricing through the [Pricing Framework for Australian Public Hospital Services](#).

The timeframes for assessing readiness for shadow pricing are outlined in **Table 1**.

**Table 1. Timeframes for proposal, consultation and commencement of shadow pricing**

Process	Process details	Timeframe
Public consultation on IHACPA's intent to shadow price	30-day public consultation period through the Consultation Paper on the Pricing Framework for Australian Public Hospital Services	June to July of the current year
Assessment of readiness for shadow pricing	Incorporation of stakeholder feedback and additional consultation where required	July to October of the current year

Process	Process details	Timeframe
Proposal for shadow pricing tabled at JAC and TAC	14-day JAC and TAC consultation period	No later than 31 October of the current year
Pricing Authority approval	Incorporation of feedback from JAC and TAC	November of the current year
Notification to health ministers of intent to progress to shadow pricing	45-day ministerial consultation period through the draft NEP Determination, which will provide detail on the new or changed classification that is being shadow priced	December of the current year
Stakeholder notification of progression to shadow pricing	Stakeholders are notified of the final decisions around shadow pricing through the publication of the Pricing Framework for Australian Public Hospital Services	December of the current year
Provision of shadow price weights	Shadow price weights and associated NWAU calculators are published alongside the final NEP Determination.	By 31 March of the following year
Commencement of shadow pricing	IHACPA and jurisdictions begin monitoring the impact of shadow pricing.	From 1 July of the following year

## 2.5 Monitoring the impact of shadow pricing

The publication of the annual NEP Determination will include shadow price weights and NWAU calculators for new or changed classifications that are being shadow priced. Groupers for new or changed classifications that are being shadow priced will also be made available to jurisdictions upon request. Where feasible, the calculations for shadow priced classifications will be incorporated into the [IHACPA data submission portal](#).

Where the implementation of groupers for shadow pricing new or changed classifications represents an undue administrative burden on jurisdictions, IHACPA will support jurisdictional evaluation of the shadow pricing period through the provision of impact analysis through JAC and TAC. This may include analysis of the potential impact of shadow pricing on NEP adjustments and on other activity streams, and assessment of the shadow pricing model against the existing pricing model.

Further information on the NEP Determination, shadow price weights and NWAU calculators can be found on the [IHACPA website](#).

# 3. Progression to pricing

In line with the *National Pricing Model Consultation Policy*, IHACPA will prepare a Statement of Impact to outline its intent to progress to pricing, as required under the Addendum, where the full two-year shadow pricing period has been undertaken or where IHACPA is proposing a reduced shadow pricing period.

As per clause A42 of the Addendum, reducing the two-year shadow pricing period requires the support of the Commonwealth and a majority of states and territories. Proposals for reductions to the two-year shadow pricing period will be discussed by jurisdictional representatives at JAC and TAC meetings, then provided to all health ministers for a 45-day consultation period through the Statement of Impact.

## 3.1 Extensions to the two-year shadow pricing period

There may be circumstances where an extension to the prescribed two-year shadow pricing period is required, in consultation with JAC and TAC. Factors that may warrant an extension to the two-year shadow pricing period may include that the:

- data collection, volume or quality is determined to be insufficiently mature or too variable across the two-year shadow pricing period to progress to pricing
- performance of shadow pricing in modelling costs is insufficient or demonstrates significant variability over the two-year shadow pricing period to the extent there is a high likelihood that performance would decrease substantially following the progression to pricing, noting that all shadow pricing models would be expected to demonstrate variability as they are refined and underlying data quality improves
- impact of progression to pricing presents a significant and unacceptable risk to funding that cannot be sufficiently mitigated.

# Appendix A: Extracts from the Addendum

Clause	Detail
A37	All parties will participate in the development of parameters of the national funding model each year, through the IHPA <sup>1</sup> process outlined in clauses B21 to B40, including efficient price, classifications and cost weights. This process will rely on transparent sharing of analysis, commissioned costing data, and shadow pricing and reporting (where appropriate) to support robust decision making.
A42	<p>The IHPA will use transitional arrangements when developing new ABF classification systems or costing methodologies, including shadow pricing classification system changes and pricing based on a costing study, for two years or a period agreed with the Commonwealth and a majority of States to ensure robust data collection and reporting to accurately model the financial and counting impact of changes on the National Funding Model.</p> <ol style="list-style-type: none"> <li>a. Where a jurisdiction participates fully in the shadow pricing, including the provision of the best available data over the shadow period to support the implementation of the new ABF classification systems or costing methodologies, the Parties agree there will be no retrospective adjustments to the National Funding Model, excluding adjustments to Commonwealth contributions as a result of service volume reconciliations as set out in clauses A63, A65 and A73.</li> <li>b. Business rules will be developed by the national bodies in consultation with Parties, addressing significance of changes, process and consultation around retrospective adjustments where appropriate.             <ol style="list-style-type: none"> <li>i. If the national bodies consider there is a potential need for a retrospective adjustment to the national funding model, national bodies will communicate, consult and collaborate with Parties. The national bodies will hold a consultation period of 45 days to allow Parties an opportunity to provide submissions on the matter.</li> <li>ii. Within 45 days following the jurisdiction 45-day consultation period, national bodies will prepare a report to the Council of Australian Governments Health Council, advising them of the national bodies' decision and the nature and circumstances of the recommended adjustment to the national funding model.</li> <li>iii. Once the report is provided to the Council of Australian Governments Health Council, the national bodies will incorporate the decision regarding the retrospective adjustment into the national funding model and provide parties with an updated report on funding entitlements from the national model.</li> </ol> </li> </ol>

<sup>1</sup> On 12 August 2022 amendments to the NHR Act came into effect changing the Independent Hospital Pricing Authority's name to the Independent Health and Aged Care Pricing Authority (IHACPA) and expanding its role to include the provision of costing and pricing advice on aged care to the Commonwealth Government.

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|  | <p>iv. When providing payment advice to the Commonwealth Treasurer following the six-month or annual reconciliation, the Administrator will include a section that notes any matters or concerns raised by State Ministers in the 45-day consultation period in the formation of that advice.</p> |
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