Good quality care increases hospital profits under prospective payment

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This study shows that, contrary to popular belief, the prospective payment system discourages skimping on medically indicated care. The quality of care on a nationally representative sample of Medicare discharges underwent judgmental review using implicit criteria. The reviewing physicians identified hospitalizations that omitted medically indicated services and diagnoses overlooked because of this skimping. After deduction for the cost of the omitted services and probability of negative diagnostic tests, good quality care would have increased hospital profits a significant 7.9 percent. As the specificity of diagnosis and intensity of treatment increase, the DRG payment rises faster than the cost of providing medically indicated services.

Background

Since October 1, 1983, Medicare has used a prospective payment system (PPS) to pay hospitals for inpatient care, as required by the Social Security Amendments of 1983. Each discharge's diagnoses and procedures “group” it to one of 477 diagnosis-related groups (DRGs). The Health Care Financing Administration (HCFA) pays the hospital a fixed amount representing the average cost for that DRG's discharges (Code of Federal Regulations, 1988). The hospital retains surpluses from discharges that cost it less than the DRG payment, and suffers losses on discharges that cost it more. The prospective payment system gives hospitals a financial incentive to reduce the unnecessary services associated with cost-based, retrospective payment.

Congress and other observers fear that prospective payment could induce hospitals to reduce necessary services (or access) (Newhouse, 1989), in addition to unnecessary services (U.S. House of Representatives, 1985; U.S. Senate, 1985; U.S. Senate, 1986b; U.S. House of Representatives, 1986a; U.S. House of Representatives, 1986b; U.S. Senate, 1986a; Prospective Payment Assessment Commission, 1990). The hospital’s need to generate financial surpluses may pressure its attending physicians to omit medically indicated tests and therapies. The institution reduces costs, while continuing to receive a DRG payment intended to cover all necessary services. This “skimming” on the quality of care may place the patient’s health at risk. If undertreatment causes the patient subsequently to need readmission, the poor quality confers a second payment upon the hospital (Averill et al., 1986).

Omission of medically indicated procedures could cause diagnostic uncertainty and may therefore produce vague ICD-9-CM codes (e.g., the classic weak, tired, and dizzy). For some discharges, good quality care (which includes an adequate workup) increases diagnostic specificity and changes the DRG assignment. When more complete workup reassigns the discharge to a DRG paid at a higher rate (adjusted for the cost of additional services and the possibility of the workup ruling out the suspected pathology), PPS rewards the hospital for good quality care. Omission of some therapeutic services also changes the DRG and therefore payment. However, omission of other services causes no change in payment, creating an economic disincentive to their delivery.

The following examples illustrate how PPS rewards (or fails to reward) quality care in the form of an adequate diagnostic workup. Suppose an elderly patient presents with sudden onset of severe chest pain, a non-specific symptom that groups to DRG 143. During Federal fiscal year 1985, PPS would have paid an urban hospital $2,013 for this admission (Federal Register, 1984). If the patient then receives an electrocardiogram that establishes ischemia, the discharge would group to DRG 140. Its $2,230 payment for angina exceeds the DRG 143 payment by $217. For 1985, Medicare Part B pays $28 for an electrocardiogram, an estimate of its average cost. Subtracting this service’s cost, the hospital still would gain $189 “at the margin” (Samuelson, 1985). The hospital therefore has a financial incentive not to skimp on quality by omitting this medically indicated service (Table 1).

Further suppose that upon confirmation of angina, the attending physician orders a routine cardiac screen of three serial electrocardiograms ($28 each in 1985) and three sets of cardiac enzymes ($19 each). These tests confirm a myocardial infarction, grouping the hospital stay to DRG 122 (Lee, 1986). Its $4,032 payment would confer $1,802 more revenue than DRG 140. Deducting
the Part B payment of $141, an approximation of procedure costs, still would leave the hospital with an increased profit.

Finally, a major cardiac workup including stress test ($109), nuclear scan ($169), echocardiography ($128), catheterization ($518), and bypass ($3,897) could push the discharge into DRG 109. The $10,917 payment for a major cardiac procedure exceeds the DRG 122 payment by $6,885. After deducting the cost of these procedures and the additional length of stay, the hospital should still profit more than for DRG 122.

However, PPS does not always reward good quality care’s diagnostic specificity with higher payment. Where the physician suspects a stroke, the increasingly specific diagnoses of weakness (DRG 464), hemiplegia (DRG 12), and cerebrovascular accident (DRG 14) carry rising payments. However, computer tomography ($97) to distinguish between hemorrhagic and ischemic disease does not change the DRG. This test, commonly used to manage the cerebrovascular accident, would confer no additional payment on the hospital.

Indeed, provision of medically indicated services may even reduce payment in some cases. A patient with a history of colon carcinoma generally needs endoscopic followup at some point. However, in 1985, DRG 412 would have paid one-half as much for malignancy after care with endoscopy, as DRG 411’s payment for aftercare without endoscopy (Brooke, 1984).

Presumably, the population of patients grouping to DRG 411 still consumes more resources than the DRG 412 population (e.g., because of more advanced disease or more expensive treatment). Alternately, did the lower DRG 412 payment deter endoscopy, confusing cause and effect?

Returning to the first example, not all electrocardiograms confirm chest pain to be angina (Fish, 1988). The proportion of positive electrocardiograms varies depending on different populations’ health status and physicians’ test-ordering patterns, but averages about 50 percent. In performing the service, the hospital would have a 0.5 probability of receiving $2,202 ($2,230 payment for DRG 140 minus $28 test costs) and a 0.5 probability of receiving $1,985 ($2,013 payment for DRG 143 minus $28 test costs). Statistically, the hospital has an expectation of $2,094. If it omits the study, it has a 1.0 probability of receiving $2,013 for DRG 143 and incurs no extra diagnostic costs. Based on these limited considerations, the economically rational hospital should perform electrocardiograms on patients presenting with appropriate chest pain symptoms because on average, it would retain net revenue of $81 after deducting the extra cost and discounting for negative tests. In this case, good quality care increases profits (Table 2).

Some of the other examples entail slightly more elaborate expectation calculations. About 29 percent of cardiac workups lead to bypass surgery, and a workup with surgery costs more than a workup without surgery. The hospital would therefore have a 0.29 probability of receiving $6,096 ($10,917 for DRG 109 minus $4,821 procedure costs) and a 0.71 probability of receiving $3,108 ($4,032 for DRG 122 minus $924 costs), for an expectation of $3,975. Not doing the medically indicated workup carries a 1.0 probability of $4,032. In this situation, providing proper care would penalize the hospital $57.

Finally, DRG 412 depends on performing endoscopy, rather than on the results of endoscopy. Since the physician largely controls the decision to do the endoscopy, it has a probability of 100 percent. That 6 percent of endoscopies yield positive findings has no bearing on the expectation calculation (Matek et al., 1985). This evaluation assumes that issues of diagnostic reliability (i.e., false positives and negatives) have little effect on payment in comparison to the other variables.

Under this analysis, a DRG sequence of increasing diagnostic specificity may increase profits. Conversely, skimping on medically indicated services maximizes hospital profits in other DRG sequences. This article gauges which trend has the greater economic effect. Overall, does prospective payment reward or penalize good quality care? Obviously, multiple factors influence medical workup and treatment decisions. In this article, we consider only the economic benefits of increasing diagnostic specificity.

### Table 1

Examples of the effect of increasing diagnostic specificity on Medicare prospective payment: Fiscal year 1985

| DRG   | Medical condition                              | Relative weight | Payment       | Payment increase |
|-------|-----------------------------------------------|-----------------|---------------|------------------|
| 143   | Chest pain                                    | 0.3743          | $2,013        | -                |
| 140   | Angina pectoris                               | 0.7470          | 2,230         | $217             |
| 122   | Myocardial infarction                         | 1.3569          | 4,032         | 1,802            |
| 109   | Myocardial infarction with bypass             | 3.0574          | 10,917        | 8,885            |
| 464   | Weakness                                      | 0.7246          | 2,163         | -                |
| 12    | Hemiplegia                                    | 1.1020          | 3,289         | 1,126            |
| 14    | Non-specific cerebrovascular accident         | 1.3366          | 3,996         | 707              |
| 14    | Intracerebral bleeding or cerebral arterial occlusion | 1.3366      | 3,996         | 0                |
| 411   | History of malignancy without endoscopy       | 0.7148          | 2,133         | -                |
| 412   | History of malignancy with endoscopy          | 0.3865          | 1,004         | 1,128            |

NOTE: DRGs is diagnosis-related group.

SOURCE: (Federal Register, 1984).
Table 2
Marginal analysis of the effect of increasing diagnostic specificity on Medicare prospective payment: Fiscal year 1985

| Diagnostic data | DRG 143 to DRG 140 change | DRG 140 to DRG 122 change | DRG 122 to DRG 109 change | DRG 109 to DRG 108 change | DRG 108 to DRG 107 change | DRG 107 to DRG 106 change | DRG 106 to DRG 105 change | DRG 105 to DRG 104 change | DRG 104 to DRG 103 change | DRG 103 to DRG 102 change | DRG 102 to DRG 101 change | DRG 101 to DRG 100 change | DRG 100 to DRG 99 change | DRG 99 to DRG 98 change | DRG 98 to DRG 97 change | DRG 97 to DRG 96 change | DRG 96 to DRG 95 change | DRG 95 to DRG 94 change | DRG 94 to DRG 93 change | DRG 93 to DRG 92 change | DRG 92 to DRG 91 change | DRG 91 to DRG 90 change | DRG 90 to DRG 89 change | DRG 89 to DRG 88 change | DRG 88 to DRG 87 change | DRG 87 to DRG 86 change | DRG 86 to DRG 85 change | DRG 85 to DRG 84 change | DRG 84 to DRG 83 change | DRG 83 to DRG 82 change | DRG 82 to DRG 81 change | DRG 81 to DRG 80 change | DRG 80 to DRG 79 change | DRG 79 to DRG 78 change | DRG 78 to DRG 77 change | DRG 77 to DRG 76 change | DRG 76 to DRG 75 change | DRG 75 to DRG 74 change | DRG 74 to DRG 73 change | DRG 73 to DRG 72 change | DRG 72 to DRG 71 change | DRG 71 to DRG 70 change | DRG 70 to DRG 69 change | DRG 69 to DRG 68 change | DRG 68 to DRG 67 change | DRG 67 to DRG 66 change | DRG 66 to DRG 65 change | DRG 65 to DRG 64 change | DRG 64 to DRG 63 change | DRG 63 to DRG 62 change | DRG 62 to DRG 61 change | DRG 61 to DRG 60 change | DRG 60 to DRG 59 change | DRG 59 to DRG 58 change | DRG 58 to DRG 57 change | DRG 57 to DRG 56 change | DRG 56 to DRG 55 change | DRG 55 to DRG 54 change | DRG 54 to DRG 53 change | DRG 53 to DRG 52 change | DRG 52 to DRG 51 change | DRG 51 to DRG 50 change | DRG 50 to DRG 49 change | DRG 49 to DRG 48 change | DRG 48 to DRG 47 change | DRG 47 to DRG 46 change | DRG 46 to DRG 45 change | DRG 45 to DRG 44 change | DRG 44 to DRG 43 change | DRG 43 to DRG 42 change | DRG 42 to DRG 41 change | DRG 41 to DRG 40 change | DRG 40 to DRG 39 change | DRG 39 to DRG 38 change | DRG 38 to DRG 37 change | DRG 37 to DRG 36 change | DRG 36 to DRG 35 change | DRG 35 to DRG 34 change | DRG 34 to DRG 33 change | DRG 33 to DRG 32 change | DRG 32 to DRG 31 change | DRG 31 to DRG 30 change | DRG 30 to DRG 29 change | DRG 29 to DRG 28 change | DRG 28 to DRG 27 change | DRG 27 to DRG 26 change | DRG 26 to DRG 25 change | DRG 25 to DRG 24 change | DRG 24 to DRG 23 change | DRG 23 to DRG 22 change | DRG 22 to DRG 21 change | DRG 21 to DRG 20 change | DRG 20 to DRG 19 change | DRG 19 to DRG 18 change | DRG 18 to DRG 17 change | DRG 17 to DRG 16 change | DRG 16 to DRG 15 change | DRG 15 to DRG 14 change | DRG 14 to DRG 13 change | DRG 13 to DRG 12 change | DRG 12 to DRG 11 change | DRG 11 to DRG 10 change | DRG 10 to DRG 9 change | DRG 9 to DRG 8 change | DRG 8 to DRG 7 change | DRG 7 to DRG 6 change | DRG 6 to DRG 5 change | DRG 5 to DRG 4 change | DRG 4 to DRG 3 change | DRG 3 to DRG 2 change | DRG 2 to DRG 1 change | DRG 1 to DRG 0 change |

Test negative

| Probability | Cost | Expectation | Probability | Cost | Expectation | Probability | Cost | Expectation |
|-------------|------|-------------|-------------|------|-------------|-------------|------|-------------|
| 0.50 | 0.42 | 0.47 | 0.17 | 0.70 | 0.80 | 0.00 | 0.00 | 0.00 |
| 2,013 | 2,230 | 4,032 | 2,136 | 3,289 | 3,996 | 2,133 | 2,133 | 2,133 |
| 1,101 | 2,257 | 1,768 | 2,705 | 1,188 | 790 | 947 | 947 | 947 |

Total expectation #

| Payment without test | Cost | Expectation | Probability | Cost | Expectation | Probability | Cost | Expectation |
|----------------------|------|-------------|-------------|------|-------------|-------------|------|-------------|
| 2,013 | 2,230 | 4,032 | 2,136 | 3,289 | 3,996 | 2,133 | 2,133 | 2,133 |
| 81 | 904 | 905 | 177 | 97 | 1,186 | 947 | 947 | 947 |

1Dehar, S., Schor, S., Kariv, L., et al.: Evaluation of electrocardiogram in emergency room as a decision-making tool. Chest 71: 486, 1977.
2McGuinness, J.B., Begg, T.B., and Sample, T.: First electrocardiogram in recent myocardial infarction. British Medical Journal 2:449, 1976.
3Sobel, E.E., and Shell, W.E.: Serum enzyme determinations in the diagnosis and assessment of myocardial infarction. Circulation 54:471-482, 1972.
4Proudfit, W.L., Welch, C.C., Sequiera, C., et al.: Diagnosis of 1,000 young women studied by coronary angiography. Circulation 84:1185-1190, 1981.
5Fischer, C.M.: Development of the clinical picture in 125 cases of cerebral thrombosis. In Adams, R.D., and Victor, M., eds. Principles of Neurology. 4th ed. New York: McGraw-Hill, 1989.
6Mills, M.L., Russo, L.S., Vines, F.S., and Ross, B.A.: High-yield criteria for urgent cranial computed tomography scans. Annual Emergency Medicine, 15:107-1172, 1986.
7Mohr, J.P., Kase, C.S., and Adams, R.D.: Cerebrovascular diseases. In Petersdorf, R.G., et al. Harrison’s principles of internal medicine. 10th ed. New York: McGraw-Hill, 1983.
8Physician-controlled.
9Probability x (test negative + test positive).
10Expectation test negative + expectation test positive.

NOTES: DRG is diagnosis-related group. CAT is computerized axial tomography.

SOURCE: (Health Care Financing Administration, 1984).

consequences of poor quality. Non-economic behaviors such as altruism, professionalism, or fear of malpractice litigation are not measured in this study.

Methods

The National DRG Validation Study employed a stratified two-stage sample design based on hospitals and discharges (Delaney, 1987). In the first stage, the Office of Inspector General (OIG), U.S. Department of Health and Human Services, used simple random sampling without replacement to select 80 hospitals from each of three bed-size strata: hospitals with fewer than 100 beds, 100 to 299 beds, and 300 beds or more. If quality of care varied by hospital size, as expected, this stratification maximized the statistical information. The design excluded specialty institutions (e.g., pediatric, rehabilitation, and psychiatric hospitals), facilities in States not using Federal prospective payment during the period studied (i.e., New York, New Jersey, Massachusetts, and Maryland), and hospitals not contributing data to the calculation of the initial relative weights assigned to DRGs. One sample hospital terminated its Medicare eligibility between the study period and actual collection of medical records, leaving a first-stage sample of 239 from a population of 4,913 acute care hospitals (Table 3).

The second stage used systemic random sampling to select up to 30 Medicare discharges (including patients who transferred to other hospitals or died) from each of the 239 hospitals for the first half of Federal fiscal year 1985: October 1, 1984 to March 31, 1985. If the hospital had fewer than 30 such discharges during this period, the sample selected all available discharges. OIG then requested a complete copy of each of the 7,076 selected medical records. With careful followup and selective use of subpoenas, it ultimately obtained 7,050 charts (99.6 percent) representing 6,900 different patients. Comparison of the records’ demographic characteristics demonstrated that the sample accurately represented the population of all Medicare beneficiaries in PPS jurisdictions (Hsia, 1988).

OIG contracted with the Baxter-Health Data Institute of Lexington, Massachusetts for registered records analysts and accredited records technicians to perform a blinded reabstraction of the ICD-9-CM disease codes supported by the chart (Ahern, 1988). In addition, specially trained registered nurses screened each record for quality of care using the Appropriateness Evaluation Protocol, a chart audit instrument of
Physicians identified four types of poor quality:

• Omission of medically indicated services (skimping).
• Provision of unnecessary services.
• Complication to indicated services (e.g., postoperative infection).
• Other.

Discharges classified as having only unnecessary services, complications, or "other" did not undergo further review because PPS provides no economic incentives promoting such behaviors. The physicians then classified the skimping discharges by type of service omitted:

• History and physical examination.
• Laboratory test (e.g., blood glucose).
• Radiology or non-invasive imaging (e.g., ultrasound).
• Other diagnostic procedure (e.g., colonoscopy, biopsy, or other invasive procedure).
• Therapy (e.g., medication, surgery).
• Other.

Finally, they identified whether the omitted services could have caused a change in ICD-9-CM codes. They selected revised diagnosis and therapy codes without knowing how these changes would affect selection DRG classification and its payment consequences. The classifiers anecdotal observed that they had no difficulty choosing the revised codes. Reliability checks disclosed no significant disagreements about revised diagnoses (agreement = 0.973, Kappa = 0.941, Z = 19.0).

Medicare-approved grouper software processed the resulting ICD-9-CM codes to determine any new DRGs resulting from addition of revised diagnoses identified by reviewers, and to assign relative weights and corresponding dollar payment. Medicare data files supplied the average Part B payment for each omitted service. These estimates of procedure cost did not warrant adjustment for increased length of stay because the omitted services proved to be minor procedures not prolonging hospitalization. For this reason, the methodology also did not adjust for the probability of complications to the omitted services. Medline literature searches provided information about the probabilities of each diagnostic test’s yielding a positive result. Spreadsheet software calculated the expectation, average change, and total change resulting from the independent variables.

A sensitivity analysis identified the variables that had the greatest influence on the final result (Stokey and Zeckhauser, 1978; Mason, 1987; Leamer, 1985). Note that despite a similar nomenclature, economic and public policy "sensitivity" bears no relationship to epidemiological "sensitivity," the percentage of positive tests among the populations of individuals with the disease (Budnick, 1987). Rather, where a projected result depended on accurate measurement of a sequence of related, independent variables, sensitivity analysis successively substituted probable high and low values for each variable for the usual point estimate (Poister, 1978). This technique produced a range (or interval) of probable results in place of the usual single result.

Dividing the output interval by each input variable’s statistic (beta) as a derivative. The bs quantified the outcome’s sensitivity to changes in the input variables. High bs variables strongly affected the outcome and therefore warranted maximum accuracy. Low bs variables had little impact on study results and therefore warranted only limited...
policy attention. Some other sensitivity analyses preferred to calculate the $\beta$ as a ratio, rather than as a derivative.

In this case, six independent variables—rate of poor quality care (of all four types), proportion of poor quality because of skimping, proportion of skimping discharges with revised DRGs, net dollar payment for revised DRGs, test costs, and proportion of positive tests—determined the dependent variable: dollar change in payment. The sensitivity analysis used the 95-percent confidence interval for each of these input variables as its estimated range. As a reality check, a second sensitivity analysis used numbers reported in the previous literature.

**Results**

**Quality**

Of the 7,050 sample discharges, reviewing physicians identified 464 (5.5 percent on strata weighting by 1985 Medicare discharges) as failing to meet professionally recognized standards for quality of care (Admire et al., 1989). Smaller hospitals had a significantly higher rate of quality problems than larger hospitals (Chi-square 120.5, 2 df, $P < 0.0001$). The good and poor quality subsamples did not differ in sex distribution (Mantel-Haenszel 0.5, 1 df, $P = 0.47$) when controlling for hospital size, but older inpatients suffered a significantly higher rate of poor quality (Mantel-Haenszel 16.2, 1 df, $P = 0.001$) (Mantel and Haenszel, 1959) (Table 4).

**Skimping**

Of the 464 patients receiving poor quality care, 87.9 percent experienced at least one instance of omitting medically necessary services. The distribution of skimping by hospital size did not significantly differ from the bed size distribution for poor quality care of all types (Chi-square 0.6, 2 df, $P = 0.76$). Inadequate diagnosis comprised 80.0 percent of the 758 individual instances of skimping, with undertreatment making up the balance (Table 5).

**Revised diagnosis-related groups**

Among the 408 discharges with skimping, proper care would have caused 63.7 percent to group to other DRGs. The proportion did not significantly differ by hospital size (Chi-square 2.3, 2 df, $P = 0.32$). Of these 260 discharges with revised diagnoses, 79.2 percent initially would have grouped to higher weighted DRGs. However, 11.2 percent of these higher weighted discharges would have become unprofitable upon deduction for the probability of negative tests and testing costs. Good quality of care therefore would have increased the hospital’s profits in 44.9 percent of the 408 skimping discharges (Table 6).

**Payment**

For all 408 skimping discharges as a group, delivery of medically indicated services still would have had a beneficial effect on hospital profits. The three groups (revised DRG higher, lower, or same) had similar estimated testing costs (averaging $56) and estimated probabilities of positive tests (averaging 50.6 percent). However, the first group’s higher frequency and larger payment difference would more than offset the other, unprofitable groups. On average, good quality care would have increased profits by a significant 7.9 percent or $147 per discharge (t-test 6.3, 406 df, $P < 0.05$) (Table 7).

| Table 4 | Quality of care, by patient demography: Fiscal year 1985 |
|---------|---------------------------------------------------------|
| Discharges | Total | Fewer than 100 | 100 to 299 | 300 or more |
|-----------|-------|----------------|-------------|-------------|
| Total | 7,050 | 2,276 | 2,388 | 2,386 |
| Good quality care | | | | |
| Under 65 years | 678 | 128 | 248 | 302 |
| 65-74 years | 2,786 | 791 | 930 | 1,065 |
| 75-84 years | 2,162 | 704 | 751 | 677 |
| 85 years or over | 980 | 394 | 307 | 259 |
| Male | 3,007 | 895 | 1,022 | 1,100 |
| Female | 3,579 | 1,132 | 1,244 | 1,203 |
| Subtotal | 6,586 | 2,017 | 2,266 | 2,303 |
| Poor quality care | | | | |
| Under 65 years | 41 | 20 | 12 | 9 |
| 65-74 years | 150 | 77 | 42 | 31 |
| 75-84 years | 418 | 84 | 40 | 24 |
| 85 years or over | 125 | 78 | 28 | 19 |
| Male | 216 | 111 | 61 | 44 |
| Female | 248 | 148 | 61 | 39 |
| Subtotal | 464 | 259 | 122 | 83 |

SOURCE: (Admire et al., 1989).
Table 5
Poor quality of care, by type: Fiscal year 1985

| Data category          | Total | Fewer than 100 | 100 to 299 | 300 or more |
|------------------------|-------|----------------|------------|-------------|
| Type of poor quality   |       |                |            |             |
| Skimping               | 408   | 238            | 101        | 89          |
| Unnecessary service    | 47    | 20             | 20         | 7           |
| Complication           | 131   | 69             | 29         | 33          |
| Other                  | 47    | 30             | 9          | 8           |
| Total poor quality     | 464   | 259            | 122        | 83          |
| Type of skimping       |       |                |            |             |
| History and physical   | 92    | 60             | 22         | 10          |
| Laboratory tests       | 205   | 123            | 55         | 29          |
| Radiology              | 150   | 89             | 38         | 33          |
| Other diagnostic       | 159   | 107            | 33         | 19          |
| Therapy                | 143   | 73             | 42         | 28          |
| Other                  | 9     | 5              | 1          | 3           |
| Total skimping         | 408   | 238            | 101        | 69          |

NOTE: Columns do not add to total because a discharge may appear in multiple rows.
SOURCE: Office of Inspector General: Data from the National DRG Validation Study.

Table 6
Skimping, by revised diagnosis-related groups (DRGs): Fiscal year 1985

| Data category          | Total | Percent of total | Fewer than 100 | 100 to 299 | 300 or more |
|------------------------|-------|------------------|----------------|------------|-------------|
| Total                  | 408   | 100.0            | 238            | 101        | 69          |
| DRG revised            | 260   | 63.7             | 158            | 58         | 44          |
| DRG not revised        | 148   | 36.3             | 80             | 43         | 25          |
| Revised DRG            |       |                  |                |            |             |
| Total                  | 260   | 100.0            | 158            | 58         | 44          |
| Higher weight          | 206   | 79.2             | 132            | 41         | 33          |
| Lower weight           | 54    | 20.8             | 26             | 17         | 11          |
| Higher weight DRGs     |       |                  |                |            |             |
| Total                  | 206   | 100.0            | 132            | 41         | 33          |
| Payment still higher   | 183   | 88.8             | 120            | 36         | 27          |
| Payment not still higher| 23   | 11.2             | 12             | 5          | 6           |

SOURCE: Office of Inspector General: Data from the National DRG Validation Study.

Sensitivity analysis

For each input variable, hospital profits increased throughout their confidence intervals. While measurement variation could have slightly increased or decreased profitability, it could not have caused unprofitability. The proportion of skimping, revised DRGs, and positive tests had low Rs, so that large changes in their values had little effect on payment. Rate of poor quality care, payment changes, and test costs had high Rs, meaning that changes in their values strongly influenced the final results. Fortunately, the latter two variables depended exclusively upon objective, reproducible billing records, and published measurements provided a comparison for the rate of poor quality care (Table 8).

A sensitivity analysis also tested previously reported values for the study's variables, where available. Input to the model, these ranges confirmed that good quality care consistently increased profits. They also corroborated the relative magnitudes of the Rs (Table 9).

Discussion

Quality

The previous literature infers the quality of care from the properties of structure, process, or outcome (Donabedian, 1966; Donabedian, 1982). Structure refers to inherent provider characteristics, e.g., does the attending physician have a current medical license? (Donabedian, 1968). Process describes provider actions, e.g., does the physician order a medically indicated test? Outcome pertains to the effect of provider actions, e.g., mortality, morbidity (Donabedian, 1980). The literature vigorously debates the merits of each type of measure, generally proposing outcome measures as a theoretical ideal and process measures as the practical reality (American Medical Association Council on Medical Science, 1986). Peer review organizations and malpractice litigation both utilize process measures as established by implicit, judgmental techniques.

The present study uses implicit process measures to classify inpatient care as either good or poor. Process measures have higher variance than structure or outcome measures, but most closely approximate the
Table 7

| Revised-DRG data   | Higher  | Lower  | Same   | Average |
|-------------------|---------|--------|--------|---------|
| Total change¹     | $107,590| -$40,176| -$7,401| $60,012 |
| Discharges        | 206     | 54     | 148    | 408     |
| Payment           | $2,366  | $3,366 | $3,146 | $3,341  |
| Revised payment   | $3,686  | $2,562 | $3,146 | $3,341  |
| Test cost         | $82     | $46    | $50    | $58     |
| Positive tests (percent) | 45.0     | 53.5    | 57.5    | 50.6    |
| Expectation²      | $2,909  | $3,122 | $3,096 | $3,005  |
| Average change³   | $523    | -$744  | $50    | $147    |
| Average change (percent)⁴ | 21.9    | -19.2  | 4.17   | 7.9     |

¹Average change × discharges.
²(positive test × (revised payment - test cost)) + ((1 - positive tests) × (payment - test cost)).
³Expectation - payment.
⁴Average change/payment.

NOTE: DRG is diagnosis-related group.

SOURCE: Office of Inspector General: Data from the National DRG Validation Study.

Table 8

| Variable                   | Point estimate | 95-percent CI | Payment change | β¹ |
|----------------------------|----------------|---------------|----------------|----|
| Poor quality of care       | 6.6            | 6.0-7.2       | $54,723-65,667 | 0.912 |
| Skimping                   | 87.9           | 85.0-90.0     | 58,033-62,062  | 0.088 |
| Revised DRGs               | 63.7           | 59.1-66.4     | 54,206-65,945  | 0.126 |
| Payment change             | 7.9            | 5.7-11.3      | 31,906-99,072  | 1.199 |
| Test cost                  | 6.0            | 5.0-7.0       | 55,574-64,451  | 1.268 |
| Positive tests             | 50.6           | 46.5-54.8     | 57,147-62,878  | 0.067 |

¹Percent change required for $10,000 payment increase: payment change / (95-percent CI range × $10,000).

Table 9

| Variable                   | Percent  | Payment change | β |
|----------------------------|----------|----------------|----|
| Poor quality of care       | 4.7, 6.2 | $42,866-65,667 | 0.912 |
| Test cost                  | 0.8-5.5  | 54,110-72,867  | 1.103 |
| Positive tests             | 6.0-6.5  | 4,149-55,933   | 0.158 |

¹Mills, 1977.
²Piltch, 1988.
³Health Care Financing Administration, Health Standards and Quality Bureau, 1975.
⁴Wetzel, A.M., and Kirz, D.S.: Routine hepatitis screening in adolescent pregnancies—Is it cost effective? American Journal of Obstetrics and Gynecology 156:195-198, 1987.
⁵Winick, R.G., Weaver, D.W., Bouman, D.L., and Sachs R.J.: Usefulness of selective preoperative chest X-ray films. American Surgery 53:396-398, 1987.
⁶Frye, E.C., Hubbell, F.A., Akin, B.V., and Rucker, L: Usefulness of routine complete blood cell counts on a general medical service. Journal of General Internal Medicine 3:373-376, 1987.
⁷Thornor, A.G., Chrislendes, M.A., and Davis, S.J.: The role of colonoscopy in the assessment of patients with colorectal cancer. Diseases of the Colon and Rectum 29:306-311, 1986.

SOURCE: Office of Inspector General: Data from the National DRG Validation Study.

physician's reasoning process (Brook, 1974). The National DRG Validation Study's finding of 5.5-percent poor quality care falls in between the 4.7 (Mills, 1977) and 7.2 percent reported in previous studies (Health Care Financing Administration, 1986; Piltch, 1988). These similar rates of poor quality care indicate the judgmental methodology to be reproducible and valid. Upon sensitivity analysis, the previous literature's proportions do not affect this article's conclusion that good quality increases hospital profits from Medicare.

**Skimping**

Confirming congressional concerns, skimping on services proves to be the most common type of poor quality care. Indeed, previous literature discusses the use of skimping as a profit maximizing strategy (Hohler et al., 1985; Stern and Epstein, 1985; Kahkonen, 1985).
Unfortunately, no studies establish the national proportion of skimping prior to 1983. Accordingly, this article cannot prove that skimping increases under prospective payment. In any event, because of its low β, variation in the rate of skimping has little effect on prospective payment profits.

Revised diagnosis-related groups

Selection of revised diagnoses introduces relatively little error. The classifiers have high inter-rater agreement. This finding parallels anecdotal observations that hospital-based peer review committees have little difficulty deciding what diagnoses their colleagues should have worked up in a particular clinical situation. The sensitivity analysis identifies this variable as having a low β. It can change Medicare profitability only slightly.

Payment

Change in payment naturally has a much greater effect on the results. However, determining payment offers little opportunity for error. The computerized grouper automatically converts the ICD-9-CM codes into a payment. Except for data entry errors, input of a given combination of ICD-9-CM codes always produces the same payment as its output. This variable's high reproducibility therefore limits any misclassification effects from its high β.

Test cost

Part B payment serves only as a crude approximation of actual test costs. Medicare receives some criticism for its payments being low in comparison with those of private insurers (Firshein, 1986). Physicians and providers assert that for selected services the Federal compensation barely covers their costs. HCFA in turn vigorously defends its methodology for setting payments (Price, 1989). Practically, beneficiaries can obtain virtually all Part B services at the Medicare price in essentially all geographic areas (Garrison, 1986). Either the payment covers costs or the provider behaves non-economically, e.g., out of a sense of professional duty to a long-time patient (Goodwin and Dolan, 1985). In any event, the sensitivity analysis demonstrates that procedure costs can have little impact on the profitability of good quality care.

Positive tests

The proportion of positive results necessarily varies from test to test. In addition, populations differ in their prevalences (e.g., cardiac screening of asymptomatics at a college versus a nursing home), and physicians differ in the clinical thresholds that trigger particular workups (e.g., computerized tomography scan for headache at an underutilized community hospital versus an overloaded public hospital) (Thompson and Krushat, 1989). This article uses secondary sources for its estimates of the proportion of tests having positive results. Had these sources used different study populations or selection methodologies, they could have reported higher or lower test yields. Fortunately, the sensitivity analysis indicates that this variable has a lesser effect on profits than do other variables. Substitution of ranges from the previous literature confirms the β.

The foregoing results refute the commonly held belief that prospective payment encourages skimping on the quality of care. Economic theory states that where revenue remains fixed, the firm should cut costs to maximize profits. In actuality, the DRG system does not necessarily fix payment. Many of its “major diagnostic categories” contain sequences of DRGs, whose diagnosis and treatment entail increasing levels of service, balanced by rising payment. Overall, not skimping on quality produces significantly higher profits despite the addition of test costs and allowance for negative tests. Accordingly, conventional wisdom is wrong in this instance.

Acknowledgments

The authors are indebted to W. Mark Krushat, Linda M. Moscoe, Brian P. Ritchie, and Barry L. Steeley of the Office of Inspector General; John R. Boyle and Walter P. Weaver of the Office of the Assistant Secretary of Management and Budget; Annette M. Delaney, Laurie H. Moore, Joseph S. Yarmus, and their staff at the Baxter-Health Data Institute; and the anonymous reviewers for their technical assistance with this project.

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