

Hospital Readmissions Reduction Program

Payment Reduction Methodology



*Beginning in fiscal year (FY) 2027, CMS is calculating excess readmission ratios (ERRs) using both Medicare Advantage (MA) and fee-for-service (FFS) data (FY 2026 Inpatient Prospective Payment System / Long-Term Care Hospital Prospective Payment System (IPPS/LTCH PPS) final rule [pages 36923-36929]). The payment adjustment factor (PAF) will continue to only be applied to all Medicare FFS base operating diagnosis-related group (DRG) payments during the FY. The PAF is not applied to MA payments.

STEP 1a

Calculate ERRs

An **ERR** is calculated for each condition or procedure, using Medicare FFS and MA data.*

$$ERR = \frac{\text{predicted readmission rate}}{\text{expected readmission rate}}$$

- The **predicted readmission rate** is the predicted 30-day readmission rate for a hospital based on its performance for its specific patient case mix.
- The **expected readmission rate** is the expected 30-day readmission rate for a hospital based on readmission rates at an average hospital with a similar patient case mix.

The **ERR** is a measure of a hospital's relative performance.



Example ERR calculations for Hospital A:

$$\text{AMI ERR: } \frac{0.1898}{0.1850} = 1.0259$$

$$\text{COPD ERR: } \frac{0.1649}{0.1574} = 1.0476$$

$$\text{HF ERR: } \frac{0.1349}{0.1251} = 1.0783$$

$$\text{Pneumonia ERR: } \frac{0.1460}{0.1459} = 1.0007$$

$$\text{CABG ERR: } \frac{0.1883}{0.1995} = 0.9439$$

$$\text{THA/TKA ERR: } \frac{--}{--} = --$$

Hospitals with no eligible discharges for a measure will not have an ERR calculated for that measure.

AMI = acute myocardial infarction; **CABG** = coronary artery bypass graft surgery; **COPD** = chronic obstructive pulmonary disease; **HF** = heart failure; **THA/TKA** = elective primary total hip and/or total knee arthroplasty.

STEP 1b

Calculate the dual proportion

The dual proportion is calculated for each hospital using Medicare FFS and MA data.

$$\text{Dual proportion} = \frac{\text{\# dually eligible stays}}{\text{total \# stays}}$$



Example dual proportion calculation for Hospital A:

Hospital A has **894** stays in which the beneficiary was dually eligible for Medicare and full Medicaid benefits.

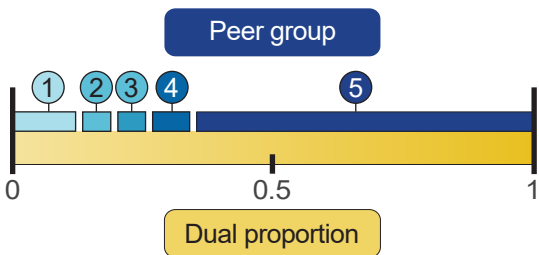
Hospital A has **3,389** total Medicare FFS and MA stays.

$$\text{Dual proportion} = \frac{894}{3,389} = 0.2638$$

STEP 2

Sort hospitals into peer groups

Sort hospitals into 1 of 5 similarly sized peer groups (i.e., quintiles) based on hospitals' dual proportions.



The yellow line represents the range of dual proportions and the blue bars represent the dual proportions of the hospitals included in each of the similarly sized peer groups.



Example peer groups:

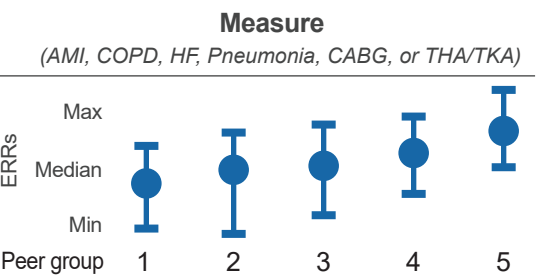
Peer group	Minimum dual proportion	Maximum dual proportion
1	0	0.1347
2	0.1348	0.1832
3	0.1833	0.2316
4	0.2317	0.3083
5	0.3084	1

Hospital A's dual proportion = **0.2638**
Hospital A is in **Peer Group 4**

STEP 3

Identify the peer group median ERRs for each condition or procedure

Identify the median ERR for each condition or procedure within each peer group.



The lines represent the range of ERRs and the circle represents the median ERR for a single measure.



Example peer group median ERRs:

Peer group	AMI	COPD	HF	Pneumonia	CABG	THA/TKA
1	0.9941	0.9943	0.9848	0.9842	0.9804	0.9841
2	0.9961	0.9944	0.9865	0.9927	0.9961	0.9969
3	0.9964	0.9956	0.9894	0.9968	0.9979	0.9901
4	0.9970	0.9954	1.0077	1.0021	1.0093	1.0073
5	1.0093	1.0104	1.0258	1.0243	1.0157	0.9989

Determine which measures will contribute to the payment reduction

For a measure to contribute to the payment reduction, it must meet two criteria:

- 1
- ERR > peer group median ERR
- 2
- Eligible discharges ≥ 25



Example determination of measures contributing to the payment reduction for Hospital A:

Measure	ERR	Peer Group 4 median ERR	ERR > Peer Group 4 median ERR	Eligible discharges	Eligible discharges ≥ 25
AMI	1.0259	0.9970	✓	42	✓
COPD	1.0476	0.9954	✓	38	✓
HF	1.0783	1.0077	✓	22	X
Pneumonia	1.0007	1.0021	X	23	X
CABG	0.9439	1.0093	X	25	✓
THA/TKA	--	1.0073	X	0	X

The **AMI** and **COPD** measures will contribute to Hospital A's payment reduction.

Calculate each measure's contribution to the payment reduction

Payment reduction for measure = *NM* x *DRG ratio* x (*ERR – peer group median ERR*)

The **neutrality modifier** is the calculated value that makes the total savings to the Medicare program generated under the peer grouping methodology[†] roughly equal to the total savings generated under the non-peer grouping methodology.[‡]

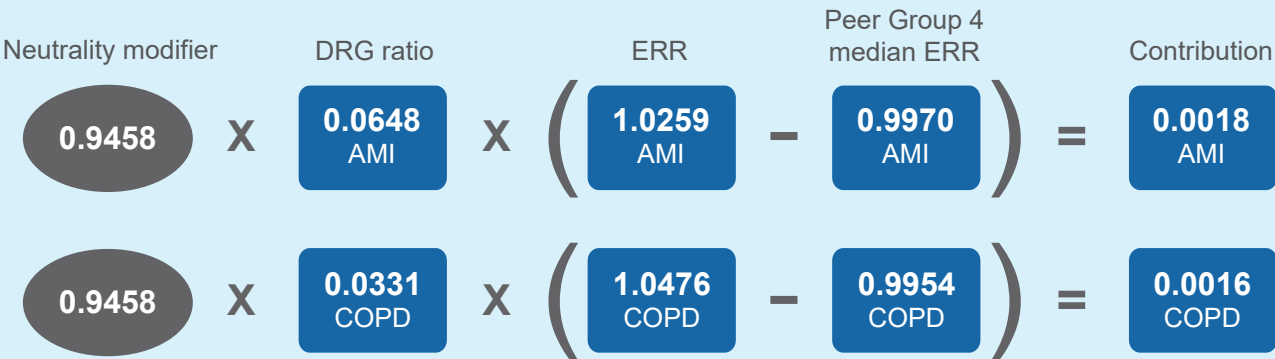
The **DRG ratio** is the ratio of Medicare FFS base operating DRG payments for the measure cohort to Medicare FFS base operating DRG payments for all discharges.

[†]The peer grouping methodology, implemented in FY 2019 in response to the 21st Century Cures Act, compares hospitals' ERRs with the peer group median ERRs.

[‡]The non-peer grouping methodology, used from FY 2013 to FY 2018, compared hospitals' ERRs with 1.0 (that is, the national average ERR).



Example calculations of measures' contributions to the payment reduction for Hospital A:



Only the AMI and COPD measures are shown in this step because these are the only two measures that will contribute to Hospital A's payment reduction (see Step 4).

Calculate the payment reduction

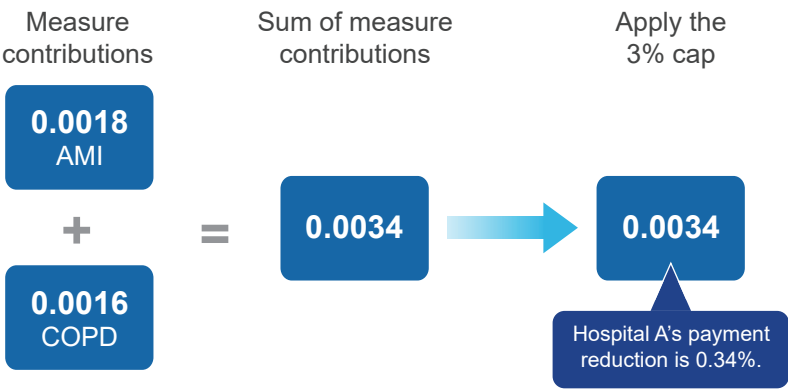
- 1
- Sum the measure contributions to the payment reduction:

Sum of measure contributions = AMI contribution + COPD contribution + HF contribution + Pneumonia contribution + CABG contribution + THA/TKA contribution

- 2
- Apply the 3% cap if the sum of the measure contributions to the payment reduction is > 0.03.



Example calculation of the payment reduction for Hospital A:



Calculate the payment adjustment factor

The PAF is the form of the payment reduction CMS uses to reduce hospitals' payments.

Payment adjustment factor = 1 – payment reduction



Example calculation of the payment adjustment factor for Hospital A:

Hospital A's payment adjustment factor = 1 – 0.0034 = 0.9966

Apply the payment adjustment factor

Payment for Medicare FFS claims submitted for the fiscal year, starting October 1 each year, equals the **Medicare FFS base operating DRG payment amount**[†] multiplied by the **payment adjustment factor**. The PAF is not applied to MA payments.

[†] In general, base operating DRG payment amounts are the Medicare FFS base operating DRG payments paid to a hospital without any add-on payments (e.g., Disproportionate Share Hospital and Indirect Medical Education payments).



Example application of the payment adjustment factor for Hospital A:

Hospital A's total Medicare FFS base operating DRG payment amount is: **\$9,842,675**

Hospital A's payment adjustment factor is: **0.9966**

Hospital A's total payment for Medicare FFS claims[†] = **\$9,842,675 x 0.9966 = \$9,809,209.91**

[†]The PAF is applied to all Medicare FFS base operating DRG payments throughout the fiscal year. The total Medicare FFS payments do not include add-on payments or adjustments from other Medicare value-based purchasing programs.