

Health Care Reform – Accountable Care Organizations

SUMMARY

Kaiser health news recently came out with two documents providing clarification on Accountable Care Organizations or ACO's that were included in the Affordable Care Act (ACA).

The mainstream media rarely discussed this. It comprised only seven pages of the health care law and dwelt with Medicare to which few critics paid serious attention.

For providers of health care, this offers a major change in the way Medicare operates. It delivers care at lower cost while maintaining quality. The ACO model can also apply to all patients, not just Medicare. Savings while maintaining quality care can run into the hundreds of billions of dollars.

A study of 4,272 hospitals found utilization levels at two of five most expensive hospitals more than 30% greater than at Mayo Clinics. The study covered Medicare patients who died. If that same service ratio held for all patients, those hospitals could generate annual savings of \$170 Billion with no change in prices. The savings occur if they had hospital days and physician visits similar to Mayo.

DISCUSSION

ACO is a network in which doctors and hospitals assume shared responsibility for patient care. ACO's would manage all the health care needs. Size matters and ACO's would need to enroll at least 5,000 beneficiaries.

The majority of Medicare recipients now get each part of their health care delivered separately. In addition to this fractured delivery, Medicare also pays any covered fee that providers submit. Combined with more aging baby boomers, this model creates an upward cost trend we cannot afford.

Medicare clearly needs to change course. To ACA's credit, it set up pilot programs to test theories. It does not impose arbitrary reductions that may not achieve the desired goals. Pilot ACO's are initially expected to cover only about 5% of Medicare recipients. Expected savings are about \$1 billion over three years. However, there is a learning curve that would yield even greater savings in later years.

Will ACO's succeed in lowering costs while maintaining quality? To see if true, one looks at similar structures that exist today. Most familiar are HMO's some of which incurred acceptance problems.

A key complaint of HMO's was the restriction to getting treatment only from providers within the network. This put a financial burden on patients who needed special treatment not available in the plan. Under the new ACO structure, patients would be allowed to see doctors outside the ACO and not pay additional amounts.

Providers like Mayo Clinic, Cleveland Clinic and Kaiser Health Care are also similar to ACO's. Unlike some HMO's, these health care practices have succeeded very well.

ACO's who save costs using integrated delivery would share savings with Medicare. While offering a profit incentive to become more efficient, Medicare would also include a penalty should costs not decrease.

The ACA deferred the actual guidelines detailing how ACO's would actually work. It then spent months in deliberation and consultation. The administration has now released proposed rules for *Medicare Shared Savings Program*.

Medicare Shared Savings Program Rules

Under proposed rules, Medicare would continue current payments to ACO providers who see at least 5,000 patients. The program encourages larger groups that can achieve greater efficiencies by increasing the reward level for greater efficiencies. It offers two ways to participate in three-year agreements.

Starting January, 2012, experienced and better performing ACO's could opt for potential bonuses of up to 60% of savings. On the flip side, a poorly performing ACO would have to repay 10 % of normal Medicare expense for cost overruns.

Newer or smaller ACO's can opt for a more conservative approach – smaller bonuses and lesser penalties until they gain size and experience and undertake more risk/reward.

Potential financial impact on health care costs.

Initial projected savings from ACO's are modest. Now all cost savings are a function of price per unit measure times the frequency or number of units incurred, just as gasoline costs for your car are a function of price per gallon times the number of gallons you buy.

Dartmouth College did an in-depth analysis of Medicare costs at 4,272 hospitals of costs in the last two years of one's life. The study broke the data into multiple components, four of which covered the bulk of medical "costs" as follows:

1. Hospital cost per day per Medicare death
2. Hospital days per Medicare death
3. Physician cost per visit per Medicare death
4. Physician visits per Medicare death

Note there are just two "costs": hospital and physician with each split into price and utilization (volume). One final step is to group these 4,272 hospitals in descending order of costs. The table below shows the top 10%, 20% and 40% as well as Mayo Clinics' prices and utilization for comparison.

Mayo's hospital "prices" are above U.S. average while its physician "prices" were a bit below U.S. average. Most striking however, was utilization (volume). Mayo recorded far fewer hospital days and physician visits than average. Since few can dispute Mayo's quality, and since Mayo is already an ACO, we can see the potential savings possible from this business model.

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From the study data, the top 40% or 2 in 5 hospitals had utilization far above average. If utilization for these hospitals had same proportion as the study's Medicare utilization, and were those hospitals to reduce them to Mayo Clinic's levels, savings would reach \$170 Billion each year. Of course, it is highly unlikely that savings would go that high, but \$100 Billion per year ought to be doable.

Note that these savings do not even address medical prices, which have contributed heavily to total medical costs. Are there pricing inefficiencies existing today? While there is no clear answer, there is a factor driving up costs called "mix."

If a group of physicians has a disproportionate number of high-priced specialists to internists, an ACO model is more

likely to bring that into balance. That alone should lower average prices.

Too many independent hospitals in an area may result in a duplication of expensive medical equipment. Again, an ACO model may find it more efficient to reduce duplication of equipment without materially affecting health care quality. Such steps also have the effect of lowering prices.

The table below details the utilization savings, for the top 10%, 20% and 40% of hospitals ranked by cost. The savings from lowering utilization to Mayo Clinic's levels are 43%, 37% and 31%. In terms of dollars, the costs and savings are based on 2001 to 2005 data. Inflation since then easily brings these savings up by 50% or more.

5 Year Cost Savings at Mayo Clinics Utilization	Highest 10% Hospitals	Highest 20% Hospitals	Highest 40% Hospitals	Mayo Foundation
Hospital Days per Death - Group	32.6	29.3	26.8	18.5
Hospital Days per Death - Mayo	18.5	18.5	18.5	18.5
Hospital Days Utilization Savings	14.1	10.8	8.3	-
Hospital Cost per Day - Group	\$ 1,395	\$ 1,288	\$ 1,180	\$ 1,316
Hospital Cost Savings per Death	\$ 19,698	\$ 13,903	\$ 9,785	\$ -
Number of Deaths	561,736	1,191,063	2,322,566	18,461
Hospital Cost Savings \$MM	11,065	16,559	22,727	-
Physician Visits per Death - Group	96.1	88.0	81.3	55.4
Physician Visits per Death - Mayo	55.4	55.4	55.4	55.4
Physician Visits Utilization Savings	40.7	32.6	25.9	-
Physician Cost per Visit	\$ 65.51	\$ 63.68	\$ 61.43	\$ 63.09
Physician Cost Savings per Death	\$ 2,663	\$ 2,076	\$ 1,589	\$ -
Number of Deaths	561,736	1,191,063	2,322,566	18,461
Hospital Cost Savings \$MM	1,496	2,472	3,690	-
5 Year Costs 2001-2005 All Costs/Savings - \$Millions	Highest 10% Hospitals	Highest 20% Hospitals	Highest 40% Hospitals	Study Group Total Costs
Hospital Costs Study Actual \$MM	25,022	44,210	72,691	119,407
Physician Costs Study Actual \$MM	3,442	6,539	11,281	18,452
% Hospital Costs to Total	21%	37%	61%	100%
% Physician Costs to Total	19%	35%	61%	100%
U.S. Hospital Costs @ study %	552,166	975,607	1,604,104	2,635,000
U.S. Physician Costs @ study %	342,149	649,897	1,121,205	1,834,000
Hospital Days Utilization Savings %	43%	37%	31%	Above totals are Actual for 2001-05
Physician Visit Utilization Savings %	42%	37%	32%	
U.S. Hospitals Potential Savings	239,200	359,910	497,164	
U.S. Physicians Potential Savings	144,764	240,630	356,678	
Total 5 Year Potential Savings	383,964	600,541	853,842	
Annual Potential Savings	76,793	120,108	170,768	
Annual Savings % of Total Spend	9%	13%	19%	893,800