

# Funding and Future Diagnosis Related Group Development

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## Abstract

**Purpose:** *Diagnosis Related Groups (DRGs) are widely used for a variety of purposes including quality improvement, hospital output measurement and funding. DRGs are a patient classification scheme which provides a means of relating the type of patients a hospital treats (i.e., its casemix) to the costs incurred by the hospital. This is done by classifying patients into mutually exclusive groups based on the patient's principal diagnosis and other information. The original Health Care Financing Administration DRGs (HCFA DRGs) have been in use since 1982. This document provides an overview of future directions for the newer DRG systems and it provides a framework for understanding the use of DRGs for funding. **Future Directions:** Newer DRG systems incorporate explicit adjustment for severity of illness, include separate measures for the likelihood of mortality, and are more independent of the underlying coding systems (e.g., ICD-10 for diagnoses, ICD-9-CM for procedures). **The Framework:** The framework for a casemix-based budgeting system consists of five basic aspects. They are: 1) Categories—which kind of DRG will be the basis for the casemix system; 2) Relative Weights—relative weights reflect the expected cost of a case in one DRG relative to the expected cost of the average patient; 3) Base Rates/Pricing—the base rate converts the relative values to prices or budgets; 4) Adjustments—adjustments account for exogenous factors; 5) Transition Policy—this provides time so hospital administrators can learn to respond to the incentives contained in the DRG system.*

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