Administrator
National Health
Funding Pool

Calculation of Commonwealth National Health Reform Funding 2017-2020

March 2018

Document Information

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Change History

Author	Date	Description	Version
NHFB	June 2017	Draft for jurisdictional comment	V1.0
NHFB	February 2018	Draft incorporating jurisdictional comments	V2.1

Approval

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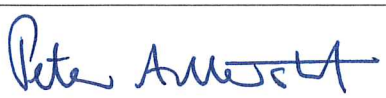
Signature	
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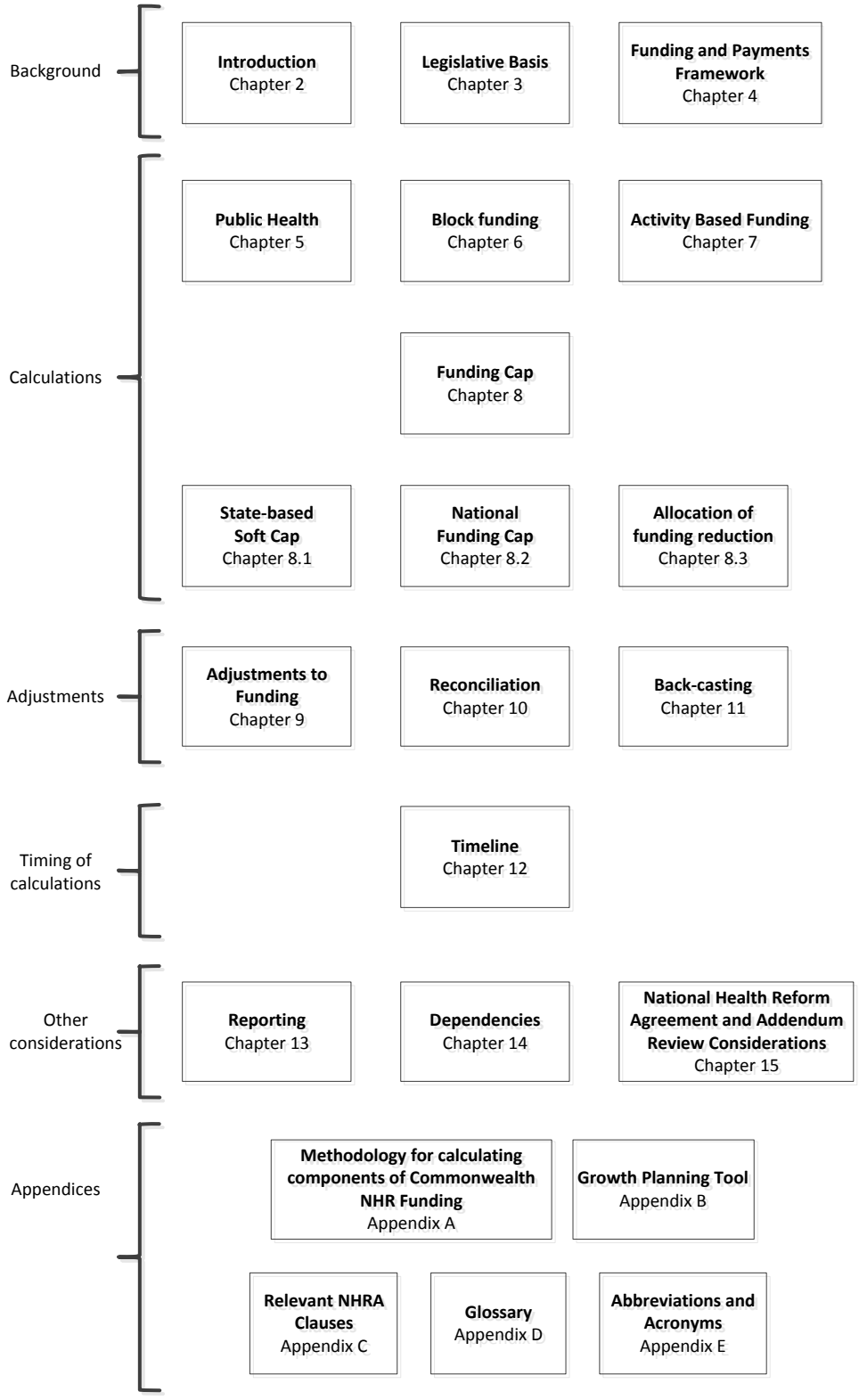
Contents

1. Document purpose and structure

This document explains the approach and method used by the Administrator of the National Health Funding Pool (the Administrator) to calculate the Commonwealth National Health Reform (NHR) funding to the states and territories (States). The structure of this document is outlined below.



2. Introduction

2.1 Background

The National Health Reform Agreement (the Agreement) introduced major reforms to the organisation, funding and delivery of health care from 2012. These reforms included the introduction of national Activity Based Funding (ABF), the national efficient price (NEP) and transparent calculation and reporting of funding and payments for public hospital services.

Under the *National Health Reform Act 2011* (the Act), corresponding legislation in each State and the Agreement, public hospitals are funded for services delivered using the Commonwealth growth calculation.

In April 2016, the Council of Australian Governments (COAG) agreed to the *Heads of Agreement between the Commonwealth and the States and Territories on Public Hospital Funding* (Heads of Agreement). The Heads of Agreement was formalised in the Addendum to the National Health Reform Agreement (the Addendum) in 2017, presented as Schedule I to the Agreement.

The Addendum introduced a series of additional reforms and amended a number of clauses of the Agreement, to be implemented from 1 July 2017, including:

- The Commonwealth NHR funding for public hospital services to maintain funding under a system of ABF based on 45 per cent of the efficient growth, with a Funding Cap of 6.5 per cent on total Commonwealth NHR funding;
- Pricing for safety and quality to be implemented progressively over the 2017-18 to 2019-20 period; and
- Improved assurance and timeliness of data submissions.

2.2 Purpose of this document

The purpose of this document is to explain the method used by the Administrator to calculate Commonwealth NHR funding paid to States. The calculation includes funding for ABF, Block and Public Health, and from 1 July 2017 includes the Funding Cap, Safety and Quality Adjustments and the Data Conditional Payment.

This document brings together the following Administrator's policy documents relating to the calculation of Commonwealth NHR funding for the period 2017-18 to 2019-20, including:

- Methodology for the Calculation of Commonwealth Contributions into the National Health Funding Pool (NHFP);
- Growth and Funding Guarantees document (1 May 2014);
- Reconciliation Framework (July 2017); and
- Determination 02: Adjustments to Commonwealth funding under the Agreement - Growth period (18 August 2014).

Separately, these documents described the policy and operational decisions of the Administrator in the calculation of Commonwealth NHR funding until 2016-17. The reforms introduced in the Addendum bring additional complexity to the calculation, and to improve clarity and understanding of the revised arrangements, the documents have been combined.

2.3 Administrator's Policy Framework

The Administrator's Policy Framework is made up of the following documents, which collectively detail the Administrator's calculation methodology, data requirements and compliance assessment process:

- Calculation of Commonwealth National Health Reform Funding Policy (this document);
- Administrator's Three Year Data Plan (the Administrator's determination of the minimum level of data required from jurisdictions) (published annually);
- Data Privacy, Secrecy and Security Policy; and
- Data Compliance Policy (the Administrator's policy for publishing details of Commonwealth, state and territory compliance with the data requirements of the Administrator's Data Plan).

2.4 Administrator's Operational Framework

The Policy Framework is underpinned by the Administrator's Operational Framework, which includes the following documents:

- Business Rules for determining 2012-13 hospital services eligible for Commonwealth funding;
- NHFP Payments System procedure manuals and user guide (procedures for authorised state and territory staff to process NHFP deposits and payments through the National Health Funding Administrator Payments System); and
- Commonwealth Contribution Model (CCM) technical and procedure manuals (explain the formulas within the CCM and procedures on how to use the CCM to determine the Commonwealth NHR funding).

2.5 Document updates

This document is subject to change and may be updated and reissued by the Administrator. Changes, if any, will be communicated to stakeholders.

Changes may include refinement of processes and/or incorporation of further information as it becomes available and is required to be reflected in this document. The changes will be summarised in this section.

3. Legislative Basis

3.1 *National Health Reform Act 2011*, National Health Reform Agreement and Addendum

Section 238(1) of the Act and associated State NHR legislation require the Administrator to calculate and advise the Commonwealth Treasurer of the amounts to be paid by the Commonwealth into the NHFP for each state and territory. This responsibility includes advising on any reconciliation of those amounts based on subsequent actual service delivery.

In 2012-13 and 2013-14, Commonwealth NHR funding to each State (via the NHFP) were equivalent to the amount that would otherwise have been payable through the National Healthcare Special Purpose Payment (SPP) (capped funding), adjusted for cross-border activity. These years were known as the 'transition years' with 2013-14 being the 'base year' for determining the funding for 2014-15 and following years.

Under the Agreement (including the Addendum), from July 2014 to June 2020 Commonwealth NHR funding is linked to the level of services delivered by public hospitals, known as the 'growth years'. During this period, each State's entitlement is directly linked to the growth in public hospital activity provided in that jurisdiction.

From 1 July 2017 to 30 June 2020, the Commonwealth NHR funding for public hospital services growth factor is 45 per cent, subject to a Funding Cap of 6.5 per cent on total Commonwealth NHR funding. The Funding Cap is made up of a National Funding Cap and a state-based Soft Cap. Pricing for safety and quality will be implemented progressively over the 2017-18 to 2019-20 period, including adjustments to funding for Sentinel Events and Hospital Acquired Complications (HACs).

3.2 *Federal Financial Relations Act 2009*

Prior to the 2012-13 financial year, Commonwealth grants for healthcare were made to the States as National Healthcare SPP under section 10 of the *Federal Financial Relations Act 2009* (the FFR Act). However, amendments were made to the FFR Act in 2012 (by the *Federal Financial Relations Amendment (National Health Reform) Act 2012*) in order to give effect to the Agreement.

In particular, section 10 of the FFR Act (providing for SPPs) was repealed, and a new provision (section 15A) was inserted into the FFR Act. The National Healthcare SPP was replaced by NHR funding which comprises base funding equivalent to the SPP (prior year amount) and, from 1 July 2014, efficient growth funding (price and volume adjustment).

Section 15A provides the following:

> **15A National Health Reform payments**
>
> The Minister may determine that an amount specified in the determination is to be paid to a State specified in the determination for the purpose of making a grant of financial assistance for the purpose of expenditure in accordance with the Agreement.
>
> A determination under subsection (1) is a legislative instrument, but section 42 (disallowance) of the Legislative Instruments Act 2003 does not apply to the determination.

Financial assistance is payable to a State under this section on condition that the financial assistance is spent in accordance with the Agreement.

Consistent with this, the Minister administering the FFR Act (the Commonwealth Treasurer) determines the amount of Commonwealth funding that is to be paid to each State Pool Account.

Section 17 of the FFR Act allows the Commonwealth Treasurer to make advances to a State of portions of the amount or amounts to which, it appears to the Commonwealth Treasurer, the State will be entitled to under section 15A for a financial year (if the total advances paid during a financial year are greater than or less than the amount to which a particular State is entitled under section 15A, relevant adjustments are made after the end of the relevant financial year). That is, the Commonwealth Treasurer does not make a determination under section 15A(1) until after the end of the relevant financial year, but the States receive advance payments throughout the financial year pursuant to section 17 of the FFR Act.

Against that background, payments by the Commonwealth to a State Pool Account are made in reliance on section 15A (and section 17) of the FFR Act, and are supported by the standing appropriation contained in section 22 of the FFR Act.

3.3 Intergovernmental Agreement on Federal Financial Relations

The Intergovernmental Agreement on Federal Financial Relations (Intergovernmental Agreement) details arrangements for the funding and delivery of government services. Schedule D provides that all National SPPs (including NHR payments) are paid by the Commonwealth Treasury to each State on the 7th day of each month.

4. Funding and Payments Framework

4.1 Role of the Administrator

The Administrator is responsible for the calculation of the Commonwealth NHR funding to States and Local Hospital Networks (LHNs) through the NHFP, undertaken in an accurate, impartial and transparent manner. Assisted by the National Health Funding Body (NHFB), the Administrator uses the CCM to undertake the growth calculation and oversees all payments made through the NHFP.

4.2 Role of the Commonwealth and States

Jointly, the Commonwealth and States are responsible for funding public hospital services in Australia. They are responsible for establishing and maintaining nationally consistent standards for health care, reporting on the performance of health services, collecting and providing data to support comparability and transparency and data sharing arrangements to promote better health outcomes.

The Agreement recognises the States as the system managers of the public hospital system. A core element of being the system manager of public hospitals is to ensure services are appropriately funded. Therefore, each State determines the amount they pay for public hospital services and functions and the mix of those services and functions, and meets the balance of the cost of delivering public hospital services and functions over and above the Commonwealth NHR funding.

In determining the mix of services and functions provided, States work with LHNs to develop Service Agreements and estimates of activity to be delivered. These Service Agreements align to the estimates provided to the Administrator for funding purposes and are updated throughout the year as needed.

The States are responsible for hospital data quality, integrity and timeliness. To enable the calculation of Commonwealth NHR funding, States collect hospital activity data as specified in the Administrator's Three Year Data Plan. The data submitted to the Administrator for Reconciliation activities is required to be complete and accurate, meeting appropriate assurance requirements.

The Commonwealth is also responsible for system management, policy and funding for GP, primary and aged care services. Their role is to promote coordinated, equitable and timely access to GP and primary health care service delivery, work with States on system-wide policy and state-wide planning for GP and primary health care, planning, funding, policy, management and delivery of aged care system.

4.3 Components of Commonwealth National Health Reform Funding

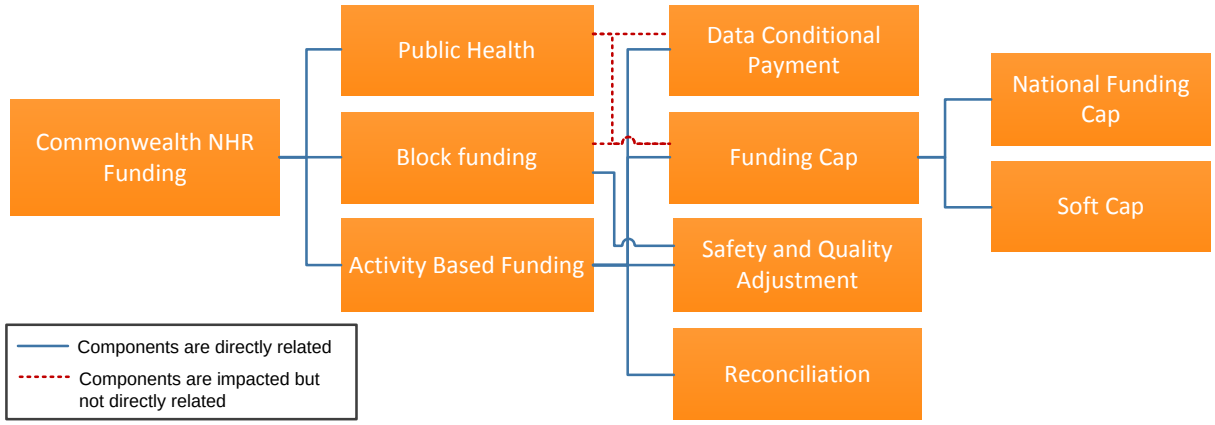
The Administrator's calculation of Commonwealth NHR funding includes the following major components:

- Public Health (Chapter 5 *Public Health Funding*), which covers amounts relating to national public health, youth health services and essential vaccines (service delivery);
- Block funding (Chapter 6 *Block Funding*), which is provided to support teaching, training and research undertaken in public hospitals and public hospital services and functions that are more appropriately funded through block grants; and
- ABF (Chapter 7 *Activity Based Funding*), which is used to fund the majority of public hospital services based on the number of services provided and the price to be paid for delivery.

Additionally, adjustments are made to the Commonwealth NHR funding for Reconciliation (Chapter 10 *Reconciliation of Actual Activity to Estimated Service Volumes*), Funding Cap (if exceeded) (Chapter 8 *Funding Cap*), Safety and Quality and Data Conditional Payment (Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*).

Figure 1 depicts the relationships between the components which make up the Commonwealth NHR funding.

Figure 1: Components of the Commonwealth NHR funding calculation



4.4 Funding and payment flows

The Agreement requires transparency and line-of-sight of respective State and Commonwealth NHR funding into and out of the NHFP to LHNs, State Managed Funds, or to State Health Departments, and the basis on which the funding is calculated.

National Health Funding Pool

Commonwealth NHR funding for public hospitals is paid monthly (1/12th of the annual amount) into the NHFP, which consists of eight State bank accounts with the Reserve Bank of Australia (State Pool Accounts).

The NHFP was established for the purposes of:

- receiving all Commonwealth NHR funding;
- receiving activity based State public hospital funding; and
- distributing funds and making payments according to the Agreement.

State Managed Fund

A State Managed Fund is a separate bank account or fund established by a State for the purposes of transacting Block funding under the Agreement.

Commonwealth Block funding flows through the NHFP to State Managed Funds and from there to LHNs.

Funding

NHR funding happens when the Commonwealth or States pay NHR funding into a State Pool Account or State Managed Fund.

Payments

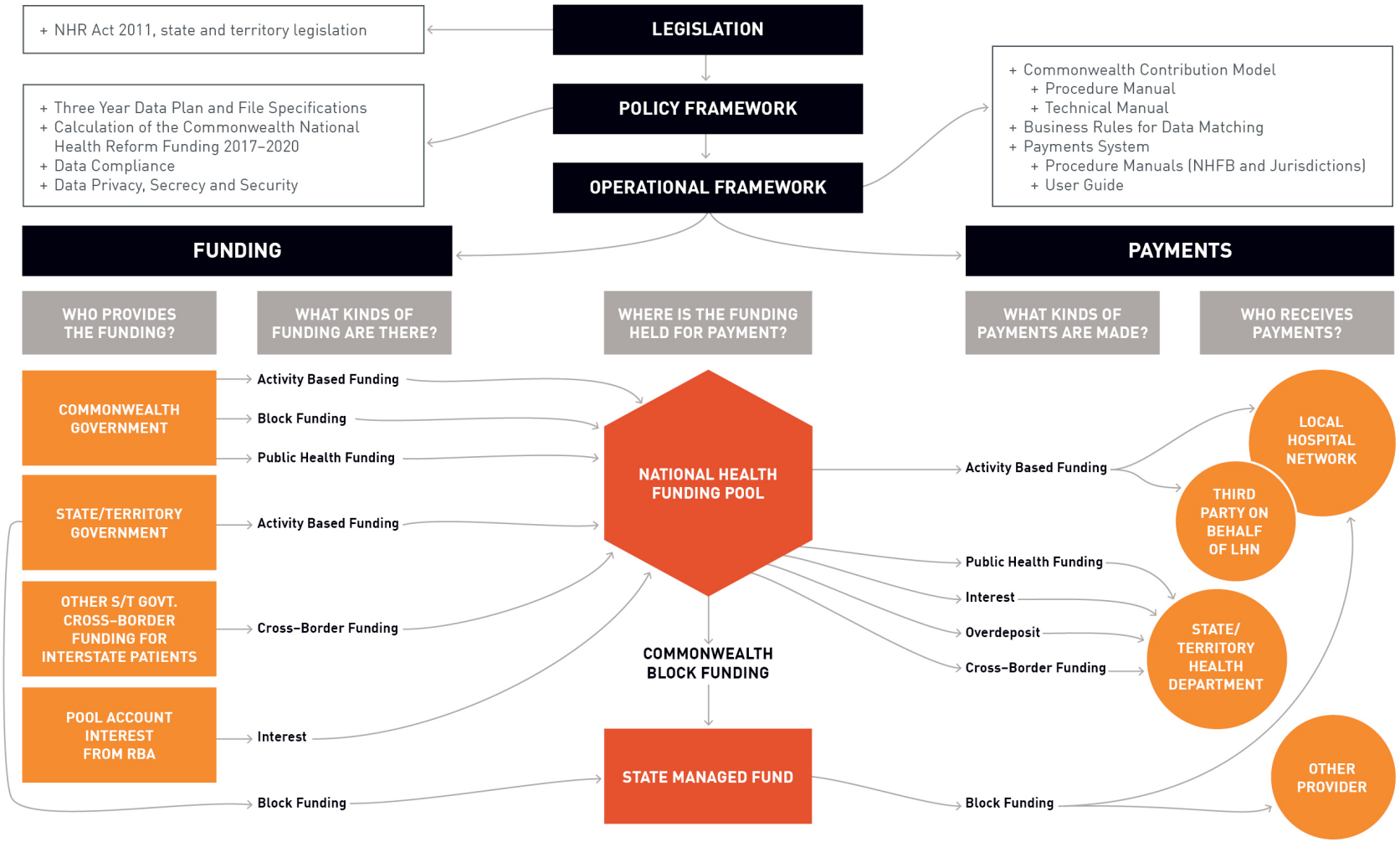
NHR payments occur when the funding deposited into a State Pool Account or State Managed Fund is paid out of the State Pool Account by the Administrator, or is paid out of the State Managed Fund by the States.

States direct the payment of Commonwealth and State NHR funding from State Pool Accounts and State Managed Funds to LHNs. The frequency of payments to LHNs by the Administrator is in accordance with advice from States.

To ensure payments flowing out of the NHFP are correct, no payment occurs until the respective State has validated (create, verify, and approve) the schedule of the payment and instructed the Administrator to make the payment on behalf of the State.

The Australian public hospital system funding and payment framework is illustrated in Figure 2.

Figure 2: Australian Public Hospital System Funding and Payment Framework



4.5 Inputs into the Commonwealth Contribution Model

The Administrator calculates the Commonwealth NHR funding into the NHFP, made up of the base year funding and growth funding, using the CCM. The Commonwealth NHR funding determined by the Administrator for prior years becomes the base for calculating the growth in Commonwealth NHR funding for the following years. To calculate growth funding, relevant inputs are required from the Independent Hospital Pricing Authority (IHPA), Commonwealth Treasury and State Health Departments.

Inputs from the Independent Hospital Pricing Authority

The IHPA determinations of the NEP and national efficient cost (NEC) enable the Administrator to calculate and provide a formal forecast of the Commonwealth NHR funding to the Commonwealth Treasurer and each State Health Minister.

IHPA also provides back-casting multipliers for each State by service category to account for any significant changes made to ABF classification systems or patient costing methodologies. The back-casting requirement is intended to ensure Commonwealth NHR funding is not adversely impacted by changes in the National Pricing Model over consecutive years.

For the purposes of calculating growth funding, the Administrator uses both the relevant financial year NEP and the back-casted base year NEP.

The IHPA also provides information to allow the Administrator to calculate the back-casted base year NEC to be used in the relevant financial year calculation for Block funded services.

The Administrator's back-casting requirements are described in further detail in Chapter 11 *Back-casting*.

Inputs from Commonwealth Treasury

To inform the Administrator's calculation, the Commonwealth Treasury is required to provide the Public Health funding for each State in relation to each financial year.

Inputs from States and Territories

Service estimates

States are required to provide the Administrator with estimates of expected activity, expressed as National Weighted Activity Units (NWAU). These are used by the Administrator to calculate the formal forecast of Commonwealth NHR funding and advise the Commonwealth Treasurer. Both Commonwealth and State payments are made prospectively based on the estimated service activity that is negotiated between the States and their LHNs.

Estimates can be provided both prior to and during the relevant financial year, formally (binding) and informally (non-binding).

Formal estimates (binding)

Prior to the relevant financial year

States must provide, at a minimum, two formal service estimates prior to the commencement of the relevant financial year:

1. Aggregate State activity by service category, due by 31 March of the preceding financial year;
2. LHN activity by service category, due by 31 May of the preceding financial year.

During the relevant financial year

If required, formal updated estimates of activity can be provided to the Administrator for funding purposes during the relevant financial year.

The Administrator encourages States to provide updated service estimates in November and March of the relevant financial year to assist with the accuracy of Commonwealth and State Budget calculations.

Adjustments advised to the Administrator by the last business day on or before the 15th of a month, take effect in the Commonwealth NHR funding in the following month. If advised later than the 15th of the month, the change takes effect in the second following month. It is expected that States update their LHN Service Agreements within 14 days of formally revising estimated activity.

The use of these estimates for ABF and the need to avoid significant cash flow variations for LHNs reinforces the need for States to have estimates that are as robust as possible and that reflect actual activity to the greatest extent possible.

Informal service estimates (non-binding)

Following the introduction of the Funding Cap, Commonwealth NHR funding outcomes for States are inter-dependent. To assist jurisdictions with budget certainty, clauses A37 and I11 allows States to provide non-binding advice of service estimates to the Commonwealth and the Administrator, without the need to vary Service Agreements.

Confidential budget planning advice may be provided to jurisdictions at any time prior to or during the relevant financial year. States are encouraged to provide non-binding estimates throughout the relevant financial year, to inform Commonwealth and State Budget calculations and assist States with internal planning processes.

Non-binding advice provided to the Administrator will be shared with the Commonwealth. The advice will not be used in the calculation of Commonwealth NHR funding for the purpose of payments or cash flows to LHNs.

5. Public Health funding

Under the Agreement, States have full discretion over the application of Public Health funding. Public Health funding covers amounts previously relating to national public health, youth health services and essential vaccines (service delivery) in 2008-09 ($244.0 million). The Administrator uses the Public Health amounts provided by Commonwealth Treasury.

The Public Health funding amount for each State grows by the former National Healthcare SPP growth factor (clauses A43, A44 and I19). The SPP growth factor is made up of:

- five year rolling average of the health price index;
- growth in population estimates weighted for hospital utilisation (nationally); and
- a technology factor (Productivity Commission derived index of technology growth).

Changes in the SPP growth factor may occur for any financial year (for example arising from the Mid-Year Economic and Financial Outlook (MYEFO)), and may lead to an adjustment to the Public Health funding.

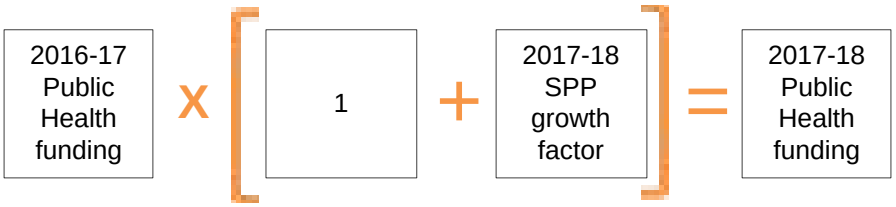
If an adjustment occurs during the year, the Commonwealth Treasury advises the Administrator of the update Public Health amounts, which may lead to a consequential change in the overall calculated Commonwealth NHR funding amount.

Any adjustment to Commonwealth NHR funding is calculated as if the underlying growth factor change related to the entire financial year. The resultant funding adjustment is spread evenly over the remaining months of the financial year (with any remainder from rounding applied to the last month). All stakeholders are advised of the change and its subsequent impact.

Calculation

For each State, the Commonwealth Treasury calculates the Public Health amount for the relevant financial year by multiplying the base year Public Health amount by the SPP growth factor (plus 'one') relating to the relevant financial year.

Figure 3: Public Health funding calculation



Commonwealth payment

Public Health funding is paid at an aggregate State level via the NHFP to State Health Departments in equal monthly amounts (clauses B46 and B52d).

The Commonwealth NHR funding is subject to a Funding Cap from 1 July 2017. For further detail of the Funding Cap (including the Soft Cap, National Funding Cap and Redistribution) see Chapter 8 *Funding Cap*.

Public Health funding may be updated by Commonwealth Treasury or impacted by other adjustments. For further detail on adjustments to funding see Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*.

6. Block funding

Block funding is calculated at a service category level for each State. Block service categories include the following:

- small rural hospitals;
- teaching, training and research;
- non-admitted mental health; and
- other non-admitted services.

Note that 'small rural hospitals' also includes major city and specialist psychiatric hospitals.

The Commonwealth funds 45 per cent of growth in the efficient cost of providing Block services or performing the functions (clauses 12, A4, A50 and A51). The Teaching, Training and Research Block component has separate provisions (clauses A47 and A48); however, the Commonwealth percentage of funding (45 per cent) is the same for all Block services.

The Administrator applies the IHPA's NEC Determination each financial year (clauses A29 to A30).

Supplementary NEC Determinations may be issued by the IHPA which may alter the Commonwealth NHR Block funding to States. Any changes to the Commonwealth NHR funding and its subsequent impact are communicated with stakeholders.

Base year Block funding calculations by the Administrator

Under the Agreement, the Administrator calculates the Commonwealth NHR funding for eligible Block services and functions using IHPA's NEC Determination.

The Block funding amounts contained in the NEC Determination are total figures (i.e. inclusive of both Commonwealth and state/territory components) for each Block funded service category. Therefore, the Administrator is required to determine the Commonwealth NHR component of this total figure.

The model for calculating Commonwealth NHR Block funding for the relevant financial year uses prior year 'base year' figures plus efficient growth.

The IHPA provides information to allow the Administrator to back-cast the base year NEC when calculating the efficient growth in funding. Components of the Block funding calculation subject to back-casting are identified in Figure 4. For further detail on back-casting, see Chapter 11 *Back-casting*.

In determining the initial 2013-14 Commonwealth NHR Block funding amounts, the Administrator consulted with each State and determined the 2013-14 Commonwealth NHR Block funding amount, to which future growth funding is added.

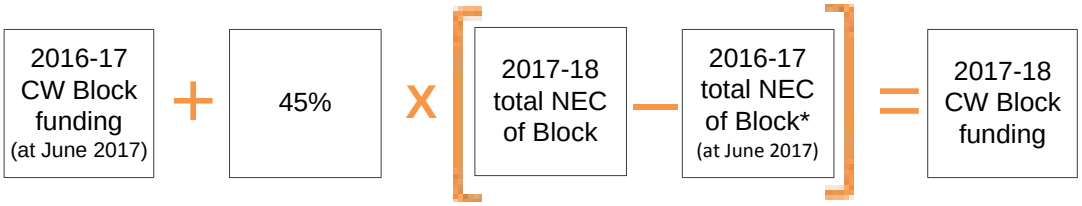
Calculation

Block funding is calculated at a service category level for each State as per the IHPA NEC Determination and Pricing Framework.

The growth funding percentage rate of 45 per cent is multiplied by the change in the NEC of each Block funding service category for each State. This amount is then added to the base year's Commonwealth NHR funding for the relevant service category to determine the Commonwealth NHR funding for the relevant financial year.

If the NEC Determination is revised, the Block funding amount is recalculated, leading to a change in the overall calculated Commonwealth NHR funding amount. The last opportunity to advise the Administrator of an alteration to take effect in the relevant financial year is 15 May.

Figure 4: Block funding calculation



**This is a back-casted figure, which is further explained in Chapter 11 Back-casting.*

From 2017-18, Block funded activities are subject to Safety and Quality Adjustment, which are applied at the time of six-month and annual Reconciliation. The Administrator deducts the Commonwealth growth funding associated with Safety and Quality events from the NEC allocation. The Commonwealth NHR funding for Safety and Quality events is calculated as 45 per cent times the NEP times the NWAU for that event. For further detail on the Safety and Quality Adjustment, see Chapter 9.4 - *Safety and Quality Adjustment*.

For more detailed calculation steps for Block funding, see Appendix A1.

Commonwealth payment

Block funding is paid at an aggregate State level via the NHFP to State Health Departments in equal monthly amounts (clauses B46, B52b and B52c).

From 1 July 2017 the Commonwealth NHR Block funding may be impacted by:

- Funding Cap (for further detail of the Funding Cap [including the Soft Cap, National Funding Cap and Redistribution] see Chapter 8 *Funding Cap*);
- Adjustments to the Commonwealth NHR funding (for further detail on other adjustments to funding, including the Safety and Quality Adjustment, see Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*);
- Reconciliation (for further detail on Reconciliation, see Chapter 10 *Reconciliation of actual activity to estimated service volumes*); and
- Back-casting (for further detail on the back-casting process, see Chapter 11 *Back-casting*).

7. Activity Based Funding

The IHPA's NEP Determination and Pricing Framework, issued prior to the commencement of the relevant financial year, determine the hospital services in scope for Commonwealth NHR funding. States provide data detailing these in scope hospital services for confirmation of eligibility by the Administrator.

The Commonwealth funds 45 per cent of efficient growth of ABF services delivered (clause I15). Efficient growth is the growth in funding related to the change in the NEP (price adjustment) and the change in the volume of services delivered (volume adjustment) for a given financial year.

As per clauses A34, A38 and clause I16, Commonwealth NHR funding is calculated for each ABF service category, individually for each State by summing the:

a) previous year (i.e. base year) amount (Commonwealth NHR funding for the previous year);

b) price adjustment; and

c) volume adjustment.

'Price adjustment' is the change in NEP between the base year and relevant financial year, and 'volume adjustment' is the change in hospital activity between the base year and relevant financial year measured in NWAU.

The ABF calculation includes back-casting of base year figures, a process for ensuring the NEP methodology is applied consistently across financial years, as per clause A40. Any changes to the classifications, counting rules or pricing methodology in the relevant financial year are back-cast to apply to the base year activity calculations.

Directly applying updated methodology or classifications to the base year activity data is not always possible, for example, where data reporting requirements have significantly changed between the base year and funding year. When base year activity data is not available, the Administrator's preferred approach is the use of a shadow data reporting year. This shadow year enables the collection of appropriate base year activity data and facilitates accurate back-casting of the base year. If a shadow year is not agreed to, conversion factors can be used to estimate the impact of the changes. This is discussed further in Chapter 11 *Back-casting.*

Components of the ABF calculation subject to back-casting are identified in Figure 5 and Examples 1 to 3. Back-casted figures are not used in the examples. For further detail on back-casting, see Chapter 11 *Back-casting*.

The requirement for ABF to be calculated at a service category level is outlined in clauses A34 and A38 of the Agreement. However it is also needed to:

- Reflect any inclusions or exclusions of ABF services and changes in the scope of services between financial years. As NHR funding arrangements continue, more services will transition to ABF services as per clauses A42b and A49.
- Account for the IHPA NEP back-casting volume multipliers and back-casted NEP (if relevant), which are developed and determined at a service category level. Refer to Chapter 11 *Back-casting* for further information on back-casting.
- Ensure that ABF is calculated on the most appropriate basis and level of accuracy.
- Allocate the Commonwealth ABF contribution correctly which (over time) differs between service categories.
- Ensure that each LHN receives the correct amount of Commonwealth ABF, reflecting its agreed scope, type and mix of ABF services provided.

There are three stages in the calculation and determination of ABF:

Stage 1. Based on estimated activity for both the base year and relevant financial year (see Example 1, page 24);

Stage 2. Based on actual activity for the base year and estimated activity for the relevant financial year (see Example 2, page 25); and

Stage 3. Based on actual activity for both the base and relevant financial years (see Example 3, page 26).

These milestones are highlighted in the Timeline in Chapter 12 *Timeline*.

The ABF calculation process is the same for each calculation stage, however the calculation basis may alter in each stage due to the inclusion of annual actual hospital activity data. Chapters 7.2 *Activity Based Funding – based on estimates* and 7.3 *Activity Based Funding – based on actuals* below provide further information on the ABF calculation using estimates and annual actual hospital activity data respectively.

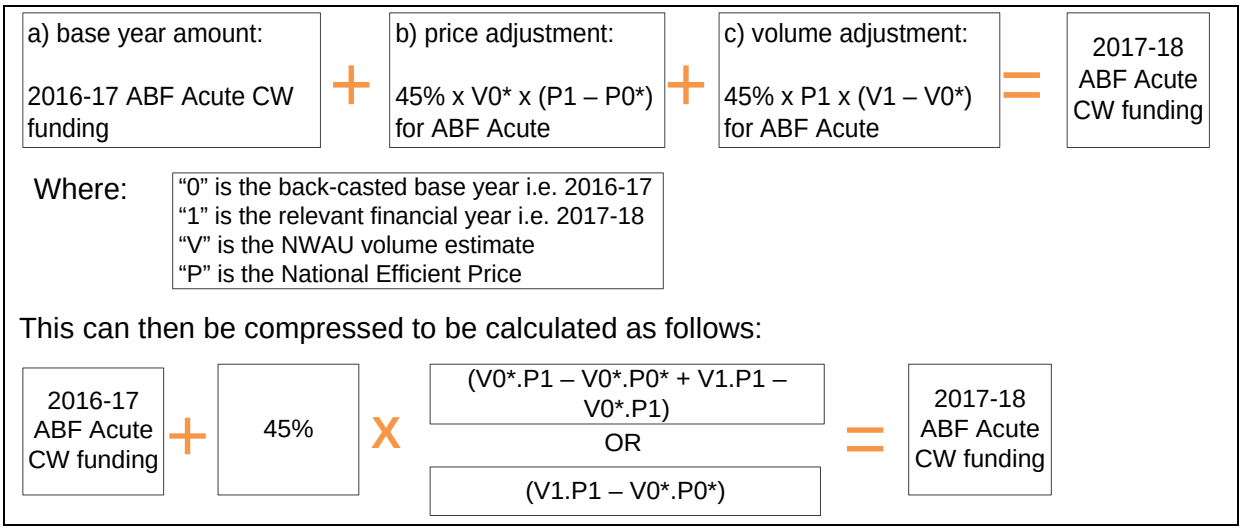
From 1 July 2017, Commonwealth NHR funding paid during the financial year to States (excluding prior year Reconciliation see below) is subject to the 6.5 per cent state-based Soft Cap (clause I20a). Final Commonwealth Funding Entitlement is subject to the 6.5 per cent National Funding Cap (clauses I10 and I20), and applied when annual Reconciliation of actual annual hospital activity data is undertaken in the following financial year. For further detail on the Funding Cap, see Chapter 8 *Funding Cap*.

Clause A89 states that Commonwealth cross-border funding flows to the provider State (where the service occurred). The quantum of services provided for interstate residents is included in each State's LHN NWAU and reflected in the Commonwealth NHR funding for ABF (for both estimates and annual Reconciliation of actual activity). This ensures each State's entire ABF service levels (including cross-border services) are included in the ABF calculation.

7.1 Activity Based Funding formula

The ABF calculation is shown in Figure 5, with the Acute admitted service category used as an example.

Figure 5: ABF calculation



**This is a back-casted figure, which is further explained in Chapter 11 Back-casting.*

For more detailed calculation steps for ABF, see Appendix A2.

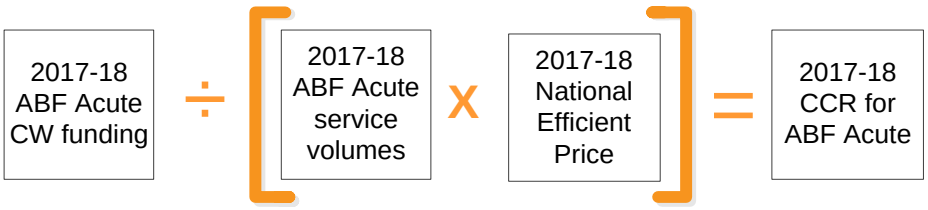
The NEP is the same for all ABF service categories, and the volume (in NWAU) is based on a State aggregation of LHN service category activity.

The ABF calculation is then incorporated into the calculation of the Commonwealth percentage funding rate as per clause A35.

The Commonwealth Contribution Rate (CCR) is calculated for each service category, by dividing the relevant financial year's calculated ABF allocation (the sum of components a, b and c in Figure 5) by the relevant financial year's aggregate volume of weighted services (NWAU) for each ABF service category multiplied by the relevant financial year's NEP.

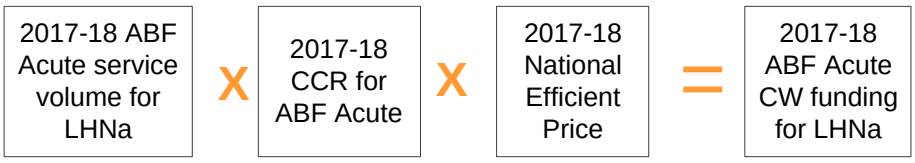
This results in a CCR for each service category for each State.

Figure 6: ABF Commonwealth Contribution Rate calculation



The Commonwealth NHR funding for ABF for each LHN by service category is determined by multiplying the LHN's NWAU by the relevant financial year's NEP, and by the relevant CCR for each service category for that State.

Figure 7: ABF calculation for each LHN



The Commonwealth NHR funding for ABF for each LHN (being the sum of the amounts for each service category) is paid via the NHFP in equal monthly amounts (clauses B46 and B52a).

7.2 Activity Based Funding – based on estimates

Prior to actual annual hospital activity data becoming available, ABF calculation and payment is based on each LHN's estimated NWAU activity by service category.

These are considered preliminary growth payment entitlements, with the final Commonwealth Funding Entitlements made after the annual Reconciliation and adjustment process in relation to that year (clause A39). This concept aligns to part 5, section 17 of the FFR Act where the Treasurer is able to make 'advances' to a State of the amount to which it appears to the Minister [the Treasurer] that the State will be entitled under part 3A of the FFR Act [NHR payments] for a financial year.

Calculation

The Administrator calculates the Commonwealth NHR ABF entitlement for each State by service category on the basis of the latest estimate of the Commonwealth Funding Entitlement for the prior year, plus an amount equal to 45 per cent of the efficient growth.

If NWAU estimates or the NEP Determination are revised, the ABF amount is recalculated, leading to a change in the overall calculated Commonwealth NHR funding amount. The last opportunity to advise the Administrator of an alteration to take effect in the relevant financial year is 15 May.

Example 1 outlines the calculation of the ABF based on estimates for both the base year and relevant financial year, with the Acute admitted service category shown in the example. The example does not include the impact of 'back-casting', which is outlined separately in Chapter 11 *Back-casting*.

Example 1: ABF – based on estimated activity for base year and relevant financial year

Information at the commencement of the relevant financial year (estimates):

2016-17 ABF Acute CW funding (at June 2017) =	$ 2,283.0 million
V1, 2017-18 ABF Acute NWAU =	1,250,264 estimate
P1, 2017-18 NEP =	$ 4,910
V0, 2016-17 ABF Acute NWAU =	1,175,418 estimate*
P0, 2016-17 NEP =	$ 4,883*

The Acute admitted allocation would be calculated as:
$2,283.0m + 45% x [(1,250,264 x $4,910) – (1,175,418* x $4,883*)] = **$2,462.7m**

The CCR for Acute admitted would be calculated as: $2,462.7m / (1,250,264 x $4,910) = 40.1%

This Acute admitted CCR would then be applied to each LHN's Acute admitted NWAU and NEP to determine its Acute admitted funding allocation.

This process would be undertaken for each service category. The sum of the service category amounts is the total Commonwealth NHR funding for ABF based on estimated activity.

Note: totals may not equal the sum of components due to rounding

**This figure is subject to back-casting, which is further explained in Chapter 11 Back-casting.*

7.3 Activity Based Funding – based on actuals

Commonwealth ABF is directly linked to the level of actual services delivered by public hospitals, subject to a Funding Cap from 2017-18.

As per clause A39, a preliminary amount for growth funding is allocated to States based on estimated data prior to the finalisation of actual hospital activity (Chapter 7.2 *Activity Based Funding – based on estimates*).

Stage 2 of the NHR funding calculations occurs when the annual actual hospital activity is reconciled for the base year. This leads to an update in the basis of the ABF calculation.

Final ABF calculations are made after the annual Reconciliation process for both the base and relevant financial year to ensure the Commonwealth meets its agreed contribution to the funding of efficient growth (clause B61). The National Funding Cap and Redistribution Pool are calculated at this time, further outlined in Chapter 8.2 *National Funding Cap*.

Calculation

The calculation of ABF, based on actual annual hospital activity relating to the base year is shown in Example 2, with the Acute admitted service category used in the example. Components that differ from the estimated activity calculation are highlighted in red and italics. The example does not include the impact of 'back-casting', which is outlined separately in Chapter 11 *Back-casting*.

Example 2: ABF – based on base year actual annual activity

Continuing on from example 1, base year annual actuals are now finalised, confirming the final ABF allocation for the base year and necessitating ABF allocation for the relevant financial year to be recalculated.

The example assumes that the State has not revised its total 2017-18 NWAU estimate (remain the same as in Example 1).

Updated information based on annual actuals:

2016-17 ABF Acute CW funding (at June 2017) =	*$ 2,213.6 million*
V1, 2017-18 ABF Acute NWAU =	1,250,264 estimate
P1, 2017-18 NEP =	$ 4,910
V0, 2016-17 ABF Acute NWAU =	*1,165,261 actual**
P0, 2016-17 NEP =	$ 4,883*

The Acute admitted funding allocation, determined using the base year annual actuals, would now be calculated as:
$2,213.6m + 45% x [(1,250,264 x $4,910) – (*1,165,261** x $4,883*)] = **$2,415.6m**

The recalculated CCR for Acute admitted is: *$2,415.6m* / (1,250,264 x $4,910) = *39.3%*

This recalculated Acute admitted CCR would then be applied to each LHN's Acute admitted NWAU and NEP to determine the Acute admitted funding allocation for each LHN.

This process would then be undertaken for each service category and summed to give the Commonwealth Funding Entitlement based on annual actual hospital activity for the base year.

Note: totals may not equal the sum of components due to rounding

**This figure is subject to back-casting, which is further explained in Chapter 11 Back-casting.*

Stage 3 of the NHR funding calculation occurs upon receipt of actual annual hospital activity for the relevant financial year, and Reconciliation of this data (Chapter 10 *Reconciliation of actual activity to estimated service volumes*).

The calculation of ABF, based on actual annual hospital activity relating to the relevant financial year is shown in Example 3, with the Acute admitted service category used in the example. The components that differ from the Example 2 (estimated activity for the relevant financial year and actual activity for the base year) are highlighted in red and italics. The example does not include the impact of 'back-casting', which is outlined separately in Chapter 11 *Back-casting*.

Example 3: ABF – based on relevant financial year actual annual activity

Continuing on from Example 2, relevant financial year annual actuals are now finalised, necessitating ABF allocation for the relevant financial year to be recalculated.

Updated information based on annual actuals:

2016-17 ABF Acute CW funding (at June 2017) =	$ 2,213.6 million
V1, 2017-18 ABF Acute NWAU =	*1,255,100 actual*
P1, 2017-18 NEP =	$ 4,910
V0, 2016-17 ABF Acute NWAU =	1,165,261 actual*
P0, 2016-17 NEP =	$ 4,883*

The Acute admitted funding allocation, determined using relevant financial year annual actuals, would now be calculated as:
$2,213.6m + 45% x [(*1,255,100* x $4,910) – (1,165,261* x $4,883*)] = **$2,426.3m**

The recalculated CCR for Acute admitted, is: *$2,426.3m* / (*1,255,100* x $4,910) = *39.4%*

This recalculated Acute admitted CCR actuals would then be applied to each LHN's Acute admitted NWAU and NEP to determine the Acute admitted funding allocation for each LHN.

This process would then be undertaken for each service category and summed to give the Commonwealth Funding Entitlement based on annual actual hospital activity.

The table below shows the final 2016-17 and 2017-18 Acute admitted funding allocations (calculated in Example 2 and 3) as well as the funding allocations for the other service categories for the State A used in the example. These amounts are relevant for determining the Funding Cap which is demonstrated in Chapter 8 *Funding Cap*.

Service category	2016-17 Uncapped funding	2017-18 Uncapped funding	2017-18 Uncapped CCR
Acute admitted	$2,213.6m	$2,426.3m	39.4%
Mental Health	$329.7m	$353.8m	39.0%
Subacute	$423.9m	$441.4m	40.0%
Emergency	$753.6m	$780.1m	42.0%
Non-admitted	$989.1m	$1,090.1m	37.0%
Total ABF	$4,709.8m	$5,091.7m	-
Block funding	$700.0m	$749.0m	
Public Health	$100.0m	$105.0m	
Total Commonwealth NHR funding	**$5,509.8m**	**$5,945.7m**	

Note: totals may not equal the sum of components due to rounding

**This figure is subject to back-casting, which is further explained in Chapter 11 Back-casting.*

7.4 Growth and Negative Growth

The total ABF is calculated in the same manner whether the net growth is positive or negative.

A decrease in expected or actual service levels (sometimes referred to as 'negative growth in volume') is treated in the same way as an increase in estimated or actual service levels. If a decrease in estimated or actual service levels is significant (relative to the base year) it may lead to a net reduction in funding compared to the previous year for one or more service categories. Similarly, a decrease in the NEP may give rise to a net reduction in funding if there is insufficient volume growth to offset the decrease in price.

From 1 July 2017 the Commonwealth NHR funding may be impacted by:

- Funding Cap (for further detail of the Funding Cap [including the Soft Cap, National Funding Cap and Redistribution] see Chapter 8 *Funding Cap*);
- Adjustments to the Commonwealth NHR funding (for further detail on other adjustments to funding, including the Safety and Quality Adjustment, see Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*);
- Reconciliation (for further detail on Reconciliation, see Chapter 10 *Reconciliation of actual activity to estimated service volumes*); and
- Back-casting (for further detail on the back-casting process, see Chapter 11 *Back-casting*).

8. Funding Cap

From 1 July 2017 to 30 June 2020, the growth in annual Commonwealth NHR funding for national public hospital services will not exceed 6.5 per cent a year (the Funding Cap) (clause I10).

The Uncapped Commonwealth Funding Entitlement for a State is its entitlement to Commonwealth NHR funding for Public Hospital Services (including ABF, Block and Public Health) in that State under the Agreement, excluding the impact of the Funding Cap.

The Funding Cap includes:

- a state-based Soft Cap of 6.5 per cent, to be applied to the Commonwealth Funding Entitlement of each State throughout the financial year (clause I20a); and
- a National Funding Cap of 6.5 per cent, to be applied to the Commonwealth Funding Entitlement for all States at annual Reconciliation.

States may be entitled to additional funding over the Soft Cap if there is funding available under the National Funding Cap (a Redistribution Pool) upon completion of the annual Reconciliation. The Redistribution Pool is determined as the total of any funding remaining under the National Funding Cap, resulting from a State with growth less than 6.5 per cent (clause I20).

The funding outcomes for each State depends upon the interaction of the National Funding Cap and each Soft Cap, summarised in Table 1.

Table 1: Summary of possible funding outcomes for States

Scenario	Soft Cap	National Funding Cap	Commonwealth Funding Entitlement	Commonwealth NHR funding (Cash payable to the State)
A	Not Exceeded	Not Exceeded	Full funding of activity	Full entitlement paid
B	Exceeded	Not Exceeded	Full funding of activity upon annual Reconciliation	Funding up to Soft Cap paid through the financial year Up to the full entitlement paid in following financial year **upon annual Reconciliation**
C	Exceeded	Exceeded	Soft Cap entitlement PLUS proportional participation in Redistribution Pool upon annual Reconciliation	Funding up to Soft Cap paid through the financial year Up to the full entitlement paid in following financial year **upon annual Reconciliation (subject to available Redistribution Pool)**

When the annual Reconciliation for the relevant financial year is completed, the Commonwealth Funding Entitlements (the Soft Cap and the National Funding Cap) for the following financial year is recalculated. This changes the overall funding entitlement and pro-rata payments for the following financial year.

The Soft Cap, the National Funding Cap and Redistribution are calculated at a national or state level, and are applied equitably to LHNs through a proportional adjustment in the calculated CCR. The calculation steps required to allocate the funding reduction to LHNs are described in Chapter 8.3 *Allocation of funding reduction.*

8.1 State-based Soft Cap

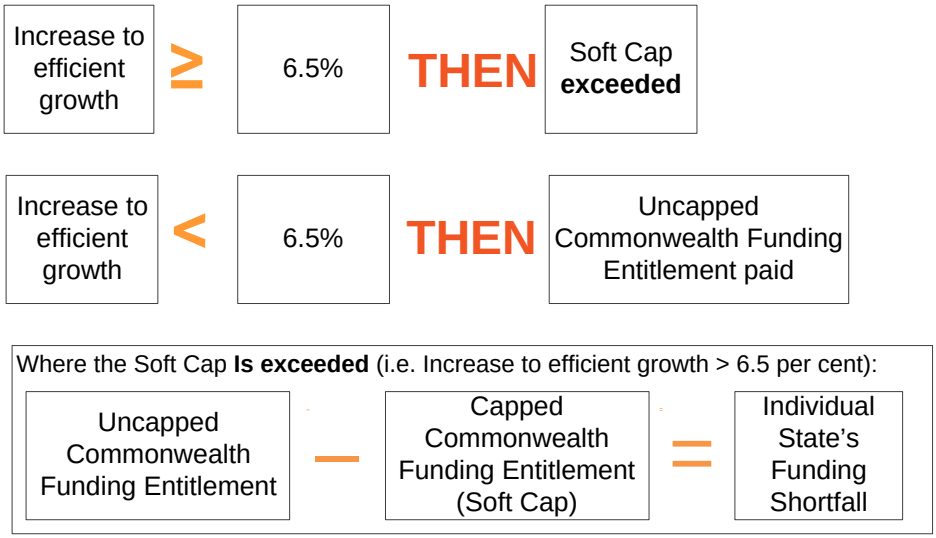
The Soft Cap is calculated as 106.5 per cent of the State's most recent estimated Commonwealth Funding Entitlement for the State for the base year, excluding any adjustments relating to prior year activities (clause I22a).The Soft Cap determines at an aggregate State level the maximum Commonwealth NHR funding payable based on estimated activity (clause I20a) for the relevant financial year.

The Soft Cap is imposed by the Administrator to any calculation of Commonwealth NHR funding through the relevant financial year to reflect amendments to input parameters. This may include updates to NWAU estimates, NEP and NEC determinations (including supplementary determinations) or changes to Public Health amounts, with changes pro-rated across the remaining monthly payments in the relevant financial year.

For avoidance of doubt, the States will not receive any Commonwealth NHR funding in excess of the state-based Soft Cap until after annual Reconciliation, at which time it may be entitled to payment of a Redistribution Amount (clause I24). When the base year funding is calculated on activity estimates, the 'base' for the relevant financial year is the latest funding entitlement for that State (i.e. Commonwealth NHR funding up to the Soft Cap).

The growth in the Uncapped Commonwealth Funding Entitlement (sum of Public Health, Block and ABF) is then compared to the state-based Soft Cap (i.e. 6.5 per cent) for each State. This is to identify if the Soft Cap is exceeded and if so, the quantum of the State's Funding Shortfall, which is represented in Figure 8.

Figure 8: Application of the Soft Cap to State Commonwealth NHR Funding



For more detailed calculation steps for the Soft Cap, see Appendix A3.

In the event that a State exceeds its Soft Cap, the calculation steps required to allocate the funding reduction to LHNs are described in Chapter 8.3 *Allocation of funding reduction.*

8.2 National Funding Cap

The National Funding Cap is applied to Commonwealth NHR funding at the time of annual Reconciliation. Under clause I27a, if a state does not exceed its Soft Cap it receives the full Uncapped Commonwealth Funding Entitlement (i.e. Scenario A in Table 1, page 27).

For more detailed calculation steps for the National Funding Cap, see Appendix A4.

If an individual State exceeds the Soft Cap, but the combined funding for all States is less than the National Funding Cap (i.e. Scenario B in Table 1, page 27), then all States receive their Uncapped Commonwealth Funding Entitlement (clause I27b). This is shown in Example 4.

Example 4: Application of National Funding Cap (Not Exceeded)

Continuing on from example 3, at annual Reconciliation the combined total Uncapped Commonwealth Funding Entitlement for States A, B and C, is $10,432.5m.

The growth for State A is above the Soft Cap with a Funding Shortfall of $77.8m (i.e. Uncapped Funding Entitlement less Soft Cap for States impacted by Soft Cap).

The growth for States B and C is below the Soft Cap with a funding available for redistribution (Redistribution Pool) of $181.7m (i.e. Soft Cap less Uncapped Entitlement for States not impacted by Soft Cap).

Since the Redistribution Pool amount is higher than the Funding Shortfall amount, State A receives the full Uncapped Commonwealth Funding Entitlement of $5,945.7m.

	2016-17	2017-18 (Uncapped)	Growth	Exceed Soft Cap?	Soft Cap	Funding Shortfall	Redistribution Pool	Redistribution Amount	Capped Entitlement
State A	$5,509.8m	$5,945.7m	7.9%	Yes	$5,867.9m	$77.8m	$0.0m	$77.8m	$5,945.7m
State B	$2,823.4m	$2,879.9m	2.0%	No	$3,006.9m	$0.0m	$127.1m	$0.0m	$2,879.9m
State C	$1,560.1m	$1,606.9m	3.0%	No	$1,661.5m	$0.0m	$54.6m	$0.0m	$1,606.9m
Total	$9,893.3m	$10,432.5m	5.4%	-	$10,536.4m	$77.8m	$181.7m	$77.8m	$10,432.5m

National Funding Cap $10,536.4m

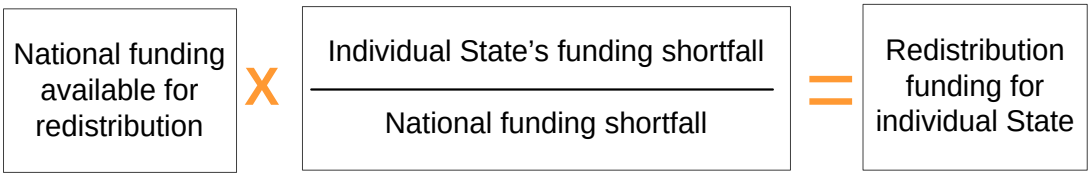
National Funding Cap exceeded No

Total Redistribution Amount $77.8m

Note: totals may not equal the sum of components due to rounding

In the event the National Funding Cap is exceeded (i.e. Scenario C in Table 1, page 27), the Administrator applies the Redistribution formula outlined in the Addendum (clause I27c). The Redistribution formula is shown in Figure 9.

Figure 9: National Funding Cap Redistribution formula



The application of the Redistribution formula to Commonwealth NHR funding and the cash payable to the State is shown in Example 5.

Example 5: Application of National Funding Cap (Exceeded)

Similar to example 4, at annual Reconciliation the combined total Uncapped Commonwealth Funding Entitlement for States A, B and C, is $10,573.6m.

The growth for States A and B is above the Soft Cap with a Funding Shortfall of $91.9m.

The growth for State C is below the Soft Cap with a funding available for Redistribution of $54.6m.

Since the Redistribution Pool amount is lower than the Funding Shortfall amount, States A and B receive a proportion of the Redistribution Pool amount.

	FY16	FY 17 (Uncapped)	Growth	Exceed Soft Cap?	Soft Cap	Funding Shortfall	Redistribution Pool	Redistribution Amount	Capped Entitlement
State A	$5,509.8m	$5,945.7m	7.9%	Yes	$5,867.9m	$77.8m	$0.0m	$46.2m	$5,914.1m
State B	$2,823.4m	$3,021.0m	7.0%	Yes	$3,006.9m	$14.1m	$0.0m	$8.4m	$3,015.3m
State C	$1,560.1m	$1,606.9m	3.0%	No	$1,661.5m	$0.0m	$54.6m	$0.0m	$1,606.9m
Total	$9,893.3m	$10,573.6m	6.9%	-	$10,536.4m	$91.9m	$54.6m	$54.6m	$10,536.4m

National Funding Cap $10,536.4m

National Funding Cap exceeded Yes

Total Redistribution Amount $54.6m

Note: totals may not equal the sum of components due to rounding

The allocation of the funding reduction to LHNs resulting from the National Funding Cap being exceeded is described in Chapter 8.3 *Allocation of funding reduction*.

The final Commonwealth Funding Entitlement (i.e. total funding to be allocated to LHNs) is equal to the sum of the Soft Cap funding and the Redistribution Amount. The difference between the funding paid throughout the financial year (up to the Soft Cap) and the Commonwealth Funding Entitlement under the National Funding Cap is paid to States upon annual Reconciliation.

8.3 Allocation of funding reduction

The Funding Cap is applied over the Uncapped Commonwealth Funding Entitlement (the sum of Public Health, Block and ABF Commonwealth Funding Entitlements).

In the event that the Funding Cap is exceeded, any adjustments to funding as a result of the Funding Cap are applied to the Commonwealth NHR funding contribution for ABF services only (clause I20c). The amount of the individual State's funding reduction is applied equitably to LHNs through a proportional reduction in the calculated CCR for each ABF service category.

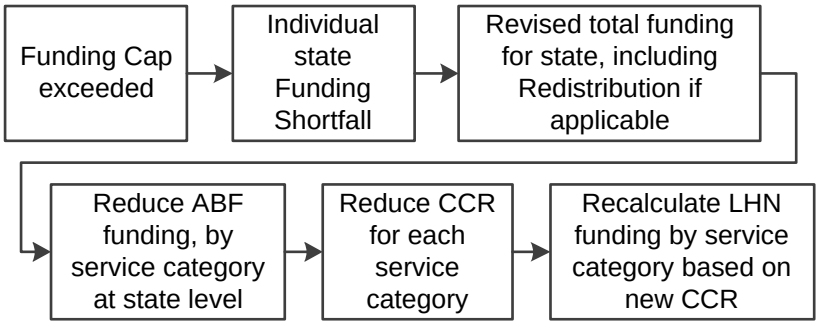
The funding reduction to a State is:

a) Based on estimates, the difference between the Uncapped Commonwealth Funding Entitlement and the Soft Cap (i.e. the Funding Shortfall); or

b) Based on actuals, the difference between the Uncapped Commonwealth Funding Entitlement and the Commonwealth Funding Entitlement (made up of the Soft Cap and the Redistribution Amount).

The Administrator's calculation process for allocating the funding reduction to LHNs is summarised in figure 11. This process applies to a funding reduction arising from either the Soft Cap or the National Funding Cap, including Redistribution.

Figure 11: Summary of calculation process for allocating the Funding Shortfall to LHNs



A State's Funding Shortfall will be calculated as described in Chapters 8.1 *State-based Soft Cap* and 8.2 *National Funding Cap*. These processes generate, where applicable, a capped Commonwealth Funding Entitlement and funding reduction.

The Commonwealth NHR funding for ABF for each LHN by service category is determined by multiplying the LHN's NWAU by the relevant financial year's NEP, and by the relevant CCR for each service category for that State, described in Chapter 7.1 *Activity Based Funding formula*.

To distribute the funding reduction to the LHNs, the CCR for each service category is recalculated using the revised funding amounts incorporating a proportional reduction.The recalculated service category CCR is then multiplied by each LHN's NWAU and NEP to determine the funding allocation for each LHN.

An example of the allocation of a funding reduction is shown in Example 6.

Example 6: Allocation of a funding reduction to LHNs

Continuing on from example 5, after the application of the National Funding Cap and Redistribution, State A has a funding reduction of $32.8m ($5,945.7m - $5,912.8m) or 0.64%.

The $32.8m funding reduction is allocated to each ABF service category by distributing the reduction in proportion with Uncapped service category funding. For Acute admitted, this means a reduction of $15.6m ($32.8m x 47.7%), with the total state-level funding for Acute admitted being $2,410.6m.

In example 3, the calculated CCR for Acute admitted was: $2,426.3m / (1,255,100 x $4,910) = 39.4%

Following the allocation of the funding reduction to service categories, the recalculated CCR for Acute admitted is: *$2,410.6m* / (*1,255,100* x $4,910) = *39.1%*

The complete allocation of the $32.8m funding reduction is described in the tabled below.

Service category	Uncapped funding	Uncapped CCR	Proportion of State's ABF funding	Funding reduction ($)	Funding reduction (%)	Capped funding	Capped CCR
Acute admitted	$2,426.2m	39.4%	47.7%	$15.6m	0.64%	$2,410.6m	39.1%
Mental Health	$353.8m	39.0%	6.9%	$2.3m	0.64%	$351.5m	38.7%
Subacute	$441.4m	40.0%	8.7%	$2.8m	0.64%	$438.6m	39.7%
Emergency	$780.1m	42.0%	15.3%	$5.0m	0.64%	$775.1m	41.7%
Non-admitted	$1,090.1m	37.0%	21.4%	$7.0m	0.64%	$1,083.1m	36.8%
Total	$5,091.7m	-	100.0%	$32.8m	0.64%	$5,058.8m	-

The funding reduction is proportionally allocated to each LHN for each service category on an NWAU basis. The recalculated service category CCR is then applied to each LHN's relevant NWAU and NEP to determine the funding allocation for each LHN.

The allocation of the Acute admitted amount to LHNs A, B and C is described in the table below.

Acute admitted	Uncapped funding	Acute Admitted NWAU	Capped Funding (NWAU x NEP [$4,910] x CCR [39.1%])	Funding Shortfall	Proportion of State's Acute NWAU
LHN A	$1,213.1m	627,550	$1,205.3m	$7.8m	50.0%
LHN B	$909.8m	470,663	$904.0m	$5.9m	37.5%
LHN C	$303.3m	156,888	$301.3m	$2.0m	12.5%
Total	$2,426.3m	1,255,100	$2,410.6m	$15.6m	100.0%

Note: totals may not equal the sum of components due to rounding

Any changes to the input parameters require the calculation process to be repeated, resulting in updated advice to the Commonwealth Treasurer and Health Ministers.

For more detailed calculation steps for the allocation of a Soft Cap funding reduction, see Appendix A3.1.

For more detailed calculation steps for the allocation of the National Funding Cap and Redistribution Amount, see Appendix A4.1.

For further detail on other adjustments to funding, including the Safety and Quality Adjustment, see Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*.

The Administrator undertakes the Reconciliation process on a six-month and annual basis. For further detail on Reconciliation, see Chapter 10 *Reconciliation of actual activity to estimated service volumes*.

9. Adjustments to Commonwealth National Health Reform Funding

There are two forms of adjustment undertaken by the Administrator to the Commonwealth NHR funding throughout the year. These can be defined as *ex-ante* and *ex-post* adjustments.

Ex-ante adjustments are those which occur prior or during the funding period (i.e. the relevant financial year), and *ex-post* are those adjustments that occur once the period has concluded (i.e. adjustments relating to prior financial years).

9.1 *Ex-ante* adjustments

The *ex-ante* adjustments are listed below and are applied in the following order:

a) Commonwealth Budget and MYEFO (e.g. update to Public Health amounts by Commonwealth Treasury);

b) changes to LHN NWAU estimates (e.g. increase/decrease to activity estimates by States);

c) revisions of the IHPA NEP and NEC determinations (e.g. issuance of supplementary determinations by IHPA); and

d) growth recalculation due to annual Reconciliation of base year actuals.

Ex-ante adjustments are calculated as if the factors giving rise to them related to the entire financial year. The resultant funding adjustment is spread evenly over the remaining months of the financial year (with any remainder from rounding applied to the last month).

Where the change results in a downward adjustment for a particular LHN that cannot be fully applied within the relevant financial year (due to insufficient Commonwealth NHR funding available), the adjustment equals the Commonwealth NHR funding available (i.e. the Commonwealth NHR funding for the remainder of the financial year is adjusted to zero). The method of recouping any remaining funds owing is discussed with the relevant State on a case by case basis.

Adjustments advised to the NHFB, on behalf of the Administrator, via nhfa.administrator@nhfa.gov.au by the last business day on or before the 15th of a month, take effect in the Commonwealth NHR funding in the following month. If advised later than the 15th of the month, the change takes effect in the second following month.

The Administrator advises each State of any revised schedule of contributions at least five days prior to the first affected Commonwealth NHR funding payment.

9.2 *Ex-post* adjustments

The *ex-post* adjustments are listed below:

a) Reconciliation (e.g. reconciliation of actual hospital activity data, Safety and Quality Adjustments, adjustments related to late provision of hospital activity data – Data Conditional Payment); and

b) adjustments for prior year issues affecting accuracy of the Commonwealth NHR funding (e.g. omission or correction of hospital activity data) , in line with clause I28 of the Addendum.

The adjustments from 2017-18 to 2019-20 are subject to Funding Cap calculations.

9.3 Reconciliation of actual hospital activity data

The Reconciliation of actual activity to estimated service volumes process, specified in clauses B59 to B64 of the Agreement, is described in detail in Chapter 10 *Reconciliation of actual activity to estimated service volumes*. When the annual Reconciliation of actual hospital services is completed, the Administrator calculates the State funding entitlements for that particular year. The Administrator then requests the Treasurer to issue a Determination under the FFR Act based on the State entitlements calculated (by the Administrator). When the Treasurer's Determination is issued, the Administrator incorporates the actuals into the Commonwealth NHR funding calculation and advises States of the adjustments resulting from the Determination and Reconciliation of annual actual activity.

9.4 Safety and Quality Adjustment

As set out in clause I60 of the Agreement, safety and quality reforms have been integrated into the pricing and funding of public hospital services. A Safety and Quality Adjustment applies to services that are:

- Sentinel Events;
- include a HAC event; or
- Avoidable Hospital Readmissions.

The Safety and Quality Adjustment is calculated as part of a State's actual NWAU during the Reconciliation process, and incorporated into the Commonwealth NHR funding through the Commonwealth growth calculation (clause I77).

Sentinel Event Adjustments are made for Sentinel Events occurring on or from 1 July 2017. The adjustment assigns an NWAU weight of zero (i.e. no funding) to services that result in the occurrence of a Sentinel Event (clause I63). States apply a digital flag to any episode that includes a Sentinel Event and report this information as part of data submissions under Clauses A8 and B93 of the Agreement (clause I64).

HAC Adjustments assign a reduced NWAU to public hospital services that result in the occurrence of a HAC. Jurisdictions intend to introduce a pricing and funding model for HACs from 1 July 2018, subject to the results of the shadow implementation to be considered by COAG Health Council (clause I65 to I69).

The pricing mechanism and timing for the implementation of the Avoidable Hospital Readmission Adjustment has not yet been finalised, pending agreement on a number of aspects of its design.

For ABF hospitals, Safety and Quality Adjustments are applied at an LHN level via the NHFP in equal monthly amounts as part of the six-month and annual Reconciliation.

For Block funded hospitals, Safety and Quality Adjustments are applied at an aggregate State level via the NHFP to State Managed Funds (deducted from the NEC Commonwealth growth funding) in equal monthly amounts as part of the six-month and annual Reconciliation.

Safety and Quality Adjustments are subject to back-casting (clause I62), with the base year figures being adjusted for the occurrence of Safety and Quality events. To enable the most accurate Commonwealth NHR funding calculation, in implementing the Safety and Quality Adjustments, the Administrator will seek the best available base year data from States (actual or proxy) for back-casting. For further detail on back-casting, see Chapter 11 *Back-casting*.

9.5 Data Conditional Payment

The Administrator is responsible for applying the Data Conditional Payment, a temporary adjustment to Commonwealth NHR funding resulting from late submission of the required data for annual Reconciliation (clauses I35 to I39).

If a State has not provided the required data within three months of the end of the Reconciliation period (i.e. 30 September) the Administrator advises the Treasurer to defer payment of 10 per cent of the amount payable to the State in November of the relevant financial year, until the required data is provided (clause I36). The deferred payment is calculated as 10 per cent of the October amount paid to the State including ABF, Block and Public Health funding.

If a State has not provided the required data within four months of the end of the Reconciliation period (i.e. 31 October), the Administrator advises the Treasurer to defer a further 15 per cent of the amount payable to the States in December of the relevant financial year, until the required data is provided (clause I37). The deferred payment is calculated as 15 per cent of the October amount paid to the State including ABF, Block and Public Health funding.

Following receipt of the required data, the Administrator advises the Treasurer that all withheld funds be paid to the State in the next monthly payment (I38).

Required data is the data requested by the Administrator in the rolling Three Year Data Plan for the purpose of annual Reconciliation. The Administrator's assessment process for compliance for the Data Conditional Payment is detailed in the Administrator's Data Compliance Policy.

9.6 Prior year adjustments

Issues may be identified with actual hospital activity data submitted in prior years for Reconciliation purposes that affect the accuracy of the Commonwealth NHR funding to that State. Such issues may require the Administrator to implement an adjustment to funding in prior years and recalculate growth for the following periods.

In making the decision on whether to adjust prior year funding, the Administrator takes in to consideration the materiality of the adjustment, the requirement for national consistency in the calculation of the Commonwealth NHR funding, and any other relevant information.

Prior year adjustments are provided and taken in to account in the next year's Treasurer's Determination as a further adjustment to the prior year amounts to be paid to States.

Under clause I28, the final Commonwealth Funding Entitlement of a State will not be adjusted unless a jurisdiction (either the Commonwealth or the State) has notified the Administrator of an issue affecting its accuracy within 12 months of the end of the relevant financial year.

9.7 Other adjustments that may be required

Other adjustments, as allowed for under the Agreement, may be required for events such as emergency responses or pilot projects. These are undertaken by the Administrator, with full disclosure of the issue and the impact to States.

10. Reconciliation of actual activity to estimated service volumes

Reconciliation of actual activity to estimates service volumes primarily relates to ABF public hospital services (clauses B63 and B64), and is the process through which the Administrator determines the actual volume of services delivered by LHNs (and thereby states) for Commonwealth NHR funding purposes.

Clauses B59 to B64 of the Agreement set out the requirements relating to the reconciliation of actual hospital activity on a six-month and annual basis each year. The NWAU attributable to the hospital activity data is calculated and reconciled to the Commonwealth NHR funding for the relevant period. Adjustments are made to the Commonwealth's NHR funding to LHNs (and therefore to states) for any difference between the actual and estimated NWAU.

The Reconciliation of services delivered in the base year affects the Commonwealth NHR funding in the relevant financial year, due to the timelines for data provision and funding adjustments in the Agreement (see Chapter 12 *Timeline*). It is important that actual activity levels are determined and the correct Commonwealth NHR funding is provided to LHNs (and thereby States) based on the actual volume of services delivered by each LHN, as this forms the basis of the Commonwealth NHR funding growth calculation for the following financial year.

To enable the Administrator to conduct Reconciliation activities in a complete and timely manner, States must provide all relevant data (clause B64) in the following timeframes as indicated in clauses B59 and B63 of the Agreement:

- six-month data (July to December of the relevant financial year) by 31 March of the relevant financial year; and
- annual data (July to June of the relevant financial year) by 30 September of the following financial year.

From 1 July 2017 with the introduction of Safety and Quality Adjustments, in addition to ABF, the Reconciliation adjustments may also impact the allocation of Block Commonwealth NHR funding.

10.1 National Weighted Activity Unit calculation

Data on actual patient level services delivered, as provided by States, are used as the basis for the calculation of NWAU.

Stages

NWAU are calculated in two broad stages outlined below, within each Reconciliation period, with results communicated to States for each stage.

Stage 1 – NWAU for all eligible services in hospital activity datasets

NWAU are calculated based on the hospital activity datasets provided by states, after appropriate validations and data preparation steps and before any adjustments are made based on eligibility of hospital services due to data matching exercises with other Commonwealth datasets, based on clauses A6 and A7 of the Agreement.

Stage 2 – NWAU for eligible services after data matching activities

NWAU are calculated for the hospital services considered eligible for Commonwealth NHR funding as a result of the data matching exercises (to other Commonwealth datasets) necessary to satisfy clauses A6 and A7 of the Agreement. This means matched records for each dataset may be excluded from the calculation of NWAU.

The difference between the NWAU figures calculated in Stage 1 and in Stage 2 for each dataset equates to the activity considered as 'matched' and therefore potentially ineligible for Commonwealth NHR funding. Any data matching activities will take place following consultation with jurisdictions.

Process

A. Submission

Hospital activity datasets are to be provided by the Commonwealth and the States within the specified timeline for each period via the provision mechanisms outlined in the Administrator's Three Year Data Plan.

The Administrator prompts jurisdictions for the provision of relevant data via correspondence with officials, relevant discussions with jurisdictions and through the Administrator's and NHFB jurisdictional committee.

From 1 July 2017, the submission of hospital activity datasets to the Administrator are required to be accompanied by a Statement of Assurance from a senior health department official on the completeness and accuracy of the approved data submissions (clause I40).

B. Validation

Upon provision, the datasets are validated by existing validation capability and specified validation rules. The validation processes include:

1. Data submission receipt and validation by the *IHPA Secure Data Management System* as per dataset specifications (i.e. format, field sequence and specification etc.).
2. Regrouping of data by IHPA.
3. IHPA providing the NHFB the validation report and corresponding Statement of Assurance for each dataset submitted by the State.

C. Identify hospitals/providers

The data provided by States may cover a wide range of hospitals/providers who receive Commonwealth NHR funding through Block or ABF. To ensure that the Administrator uses data relating only to those hospitals and providers that are subject to Reconciliation, a list of ABF providers is used as per State advice, including within which LHN each hospital and provider sits.

Any alterations to the ABF hospital list are required to be advised to the Administrator as soon as possible for the change to be reflected in the relevant Reconciliation process.

This list of ABF hospitals is compared to the list of hospitals in the NEC for the relevant financial year as determined and advised by IHPA and used in the calculation of Block funding. This comparison is made to ensure that hospitals are not funded under both Block and ABF.

From 1 July 2017, the identification of Block funded providers is also required for the purpose of applying the Safety and Quality Adjustment.

D. Patient/aggregate level data usage

As part of the State advice outlined in 'Step C' above, States also advise whether patient level and/or aggregate level data is to be used for each respective provider (depending on State data provision) for non-admitted and emergency department/services data.

States are required to provide 'patient identified data regarding actual services delivered for those public hospital functions funded by the Commonwealth on an activity basis to enable reconciliation to be undertaken' under clause B63.

If patient level data is not available, the Administrator seeks the best available data from States to enable the most accurate Commonwealth NHR funding calculation and payment advice possible.

This advice is used to identify the relevant NHR in-scope services and functions that are eligible to receive Commonwealth NHR funding.

Any subsequent alterations to the use of patient/aggregate level data for the relevant financial year are required to be advised to the Administrator as soon as possible for the change to be reflected in the relevant Reconciliation process.

E. In-scope hospital services (determined by IHPA)

Clauses A9 to A26 of the Agreement state that IHPA is responsible for determining the scope of services eligible for Commonwealth NHR funding.

This determination is conveyed annually in IHPA's NEP Determination for public hospital services eligible for Commonwealth NHR funding.

F. Assessment of the General List of eligible services (advised by IHPA)

As per clause A12 of the Agreement, IHPA defines the 'General List' of hospital services in-scope for Commonwealth NHR funding. IHPA then assesses proposals from states for individual services to be included under that General List. The final General List is forwarded to the Administrator for Commonwealth NHR funding purposes.

As directed and advised by IHPA, the in-scope services identified as belonging to in-scope hospitals are then subject to an assessment of the applicability of services contained in the General List.

The evaluation of each individual service is conducted by IHPA, with the Administrator and the NHFB advised of a matrix of in-scope services by LHN and Tier 2 clinic (for non-admitted services) and whether they are considered eligible for Commonwealth NHR funding.

G. Administrator's calculation parameters

To undertake the successful and accurate calculation of NWAU, it is necessary for the Administrator to apply certain calculation parameters. These calculation parameters are outlined in an Administrator's determination.

H. Exclusion of services paid via other Commonwealth funding streams

This step reflects the intent of a component of clause B63 of the Agreement, which states "*… Variations for the service volume reconciliation will include, but not be limited to, … the exclusion of services paid for by the Commonwealth via other funding streams …*".

Where the Commonwealth funding source can be clearly identified for the respective record in the hospital activity datasets provided by States, these are excluded from the final calculation of NWAU for Commonwealth NHR funding purposes.

The exclusion of services in this step in comparison to Step J is outlined below:

- Step H – exclusion of services funded by other Commonwealth programs based on hospital activity datasets provided by States (clause B63).
- Step J – exclusion of services funded by other Commonwealth programs based on data matching activities to other Commonwealth datasets (clauses A6 and A7).

I. NWAU calculation – stage 1

There are two broad NWAU calculation stages for each Reconciliation period – one prior to data matching activities outlined under clauses A6 and A7 of the Agreement and described in 'Step J' and one following data matching activities as per 'Step K'. The NWAU calculation processes for both are the same, with the only difference being the activity considered as 'matched' to other relevant Commonwealth datasets and therefore considered ineligible for Commonwealth NHR funding.

In-scope and eligible services data is used to calculate NWAU by running the relevant data elements for these services through the IHPA NWAU calculators, price weights and reference files. Unique NWAU calculators are used for each activity stream and classification. The NWAU calculators and *National Pricing Model Technical Specification* for each financial year are published on the IHPA website for transparency of the calculation process.

It is important the calculation of NWAU for the Administrator's Reconciliation processes is based precisely on the formula developed by IHPA to ensure accuracy and transparency of calculations.

States are able to access the NWAU calculators published on IHPA's website to calculate consistent NWAU figures.

Given the volume and characteristics of the data, SAS software is necessary as the mechanism for conducting calculations. Access to the IHPA SAS NWAU calculator codes for each financial year and ABF service category has been granted by IHPA to the NHFB to assist in the operation of the Administrator's functions.

The Administrator and the NHFB liaise with IHPA to ensure the NWAU calculation approach and basis is consistent between both parties in each Reconciliation period.

The Administrator and NHFB undertake a number of analyses to ensure data are processed correctly. A summary of these checks is outlined below.

- Reasonableness checks on the distribution of the data (by age, Indigenous status, location, classification, service category, etc.)
- Reasonableness of the NWAU outcomes (by State, LHN, Hospital, Service Category)
- Comparing the outcomes to previous years to detect any variations
- Ensuring the IHPA NWAU calculator and Technical Specifications, and States provided information is correctly applied (e.g. hospital ABF listing and the use of aggregate and patient level data)

The Safety and Quality Adjustments are applied at this step.

J. Data matching activities (clauses A6 and A7)

As per clauses A6 and A7 of the Agreement, it is necessary for the Administrator to evaluate if ABF hospital services are eligible for Commonwealth NHR funding under the 'data matching' requirements, where hospital activity datasets are compared to MBS and PBS claims data to evaluate if there are any matches. These services are then reviewed to determine whether they remain eligible for Commonwealth NHR funding.

For further information refer to the Administrator's data matching document, *Business Rules Volume 2 Extended proof of concept*, for determining hospital services eligible for Commonwealth funding.

The Administrator's decision to apply data matching activities will be detailed in an annual determination.

K. NWAU calculation – stage 2

NWAU calculation as per 'Step I' is conducted, incorporating the outcomes of the data matching activities conducted in 'Step J'.

L. Safety and Quality Adjustment for Block funded services

The NWAU associated with Safety and Quality events are deducted from the Commonwealth NHR funding for the NEC allocation (calculated using the 45 per cent times NEP times NWAU for that event).

M. Advice to jurisdictions

States are advised of the outcomes and associated documentation relating to their jurisdiction each Reconciliation period, including:

- Structured Reconciliation and data matching (where relevant) outcomes document. This document outlines a high level summary of the data submission, data preparation, NWAU calculation (pre and post data matching) and data matching outcomes at an aggregate state level. Further detail regarding each hospital and LHN is provided via a separate mechanism (detailed below).
- State summary of the NWAU calculation by each ABF hospital and LHN, including the total number of services, number of in-scope services and number of NWAU for each service category.
- Each State's data by each record item including the NWAU (inclusive of loadings), ABF flag, in-scope flag and cross-border flag, where applicable.
- Sentinel Event Adjustments or Safety and Quality Adjustments.

N. Data resubmission (if required)

To ensure Commonwealth NHR funding calculations (including Reconciliation outcomes) are as robust as possible, the Administrator may consider requests from jurisdictions to resubmit data. Resubmissions may be desired to correct errors, anomalies or omissions in the previous data provided or any other relevant circumstance.

Outlined below is a high-level protocol for data resubmissions.

1. Flag intention to request resubmission of data with NHFB

As early as possible the relevant State flags its intention to request the Administrator's approval to resubmit data to the NHFB, including the rationale for the resubmission.

The Reconciliation and adjustment time frames should be considered by States and the NHFB in this step.

2. NHFB continues to work with the jurisdiction

The NHFB continues to liaise with the State to track the progress and suitability of the data.

3. Formal data resubmission request sent to the Administrator

If data resubmission is desired by the State, a formal request from an appropriate jurisdictional official is to be provided to the Administrator. This request must include which dataset(s) is requested to be resubmitted and the rationale for the resubmission.

4. Administrator considers the resubmission request

Under the Agreement, the Administrator (or the NHFB on behalf of the Administrator) is not obliged to accept data resubmissions. In assessing whether resubmission is appropriate, the Administrator will assess whether accepting the resubmission compromises the timeliness and quality of the Reconciliation process and consequential Commonwealth NHR funding calculations. The Administrator discusses with IHPA the ability and timelines for data validation. Data cannot be incorporated into Reconciliation activities without this validation process; therefore the ability of IHPA to validate ad-hoc data is essential.

5. Administrator responds to the resubmission request

Based on the assessment in step 4, the Administrator responds to the relevant jurisdiction. This response could be either:

a) Resubmission is supported

Along with the response, the Administrator provides a timeline for data resubmission. This timeline allows sufficient time for the associated processing, validation, and Reconciliation calculations and for these be included in the Commonwealth NHR funding calculation. This timeline must be met.

b) Resubmission is not supported

The Administrator's response includes the rationale for the resubmission not being supported, and any follow up or remedial action that can be taken.

6. Data are collated and resubmitted (if step 5a occurs)

The jurisdiction addresses and corrects the issue that instigated the resubmission and resubmits the relevant data to the Administrator. The jurisdiction develops strategies to mitigate the need occurring in future data submissions.

A Statement of Assurance from a senior health department official on the completeness and accuracy of the approved data submissions should be provided at the time of the resubmission.

7. Advise other jurisdictions

If the resubmission impacts other jurisdictions, for example the Reconciliation adjustment timelines are deferred, the Administrator advises the other jurisdictions accordingly.

Depending on the ability and timelines of the Reconciliation process, the Administrator may elect to offer all jurisdictions the opportunity to resubmit relevant datasets, where they view this as necessary. This opportunity is not guaranteed and is at the discretion of the Administrator.

The Administrator may request data re-submission from States to correct for inaccuracies or errors within 12 months of the end of the financial year (clause I28). In this instance, steps 6 and 7 would be followed.

O. Advice to the Commonwealth Treasurer

The Administrator provides advice to the Commonwealth Treasurer upon completion of the annual Reconciliation, outlining the basis of the calculated Commonwealth NHR funding. This includes analysis of growth in Commonwealth NHR funding, hospital activity and NWAU across State, LHNs and service categories.

The Commonwealth Funding Entitlement of States with reported Sentinel Events, and Safety and Quality Adjustments will be advised to the Commonwealth Treasurer (clause I86). The Commonwealth Funding Entitlement of States with reported Sentinel Events will also be reported following the six-month Reconciliation.

P. Bilateral sharing of cross-border data

Each State receives a cross-border dataset with information for patients reported to be residents of that State who received a public hospital service in another State. This data includes the patient level data, by record item, for ABF and Block funded hospitals services. It is provided in the format described in Step M.

NWAU calculation groupings

NWAU are calculated in total for each of the following groupings:

Service category

Hospital activity datasets and IHPA NWAU calculator codes are constructed separately for each activity stream and classification. As such, NWAU are calculated separately for each ABF service category to ensure calculations are conducted in the most accurate manner.

In addition, this level of detail is necessary for the accurate determination of growth funding as per clauses A34, A35, A36 and A38.

LHN

Commonwealth ABF contributions are calculated and allocated by an NWAU figure for each LHN (incorporating service category detail); therefore the actual number of NWAU delivered by each LHN is required for Commonwealth payment purposes. This figure is an aggregate of the actual NWAU for each service category for each LHN.

State

The aggregate of actual LHN NWAU in each State is required to calculate the actual percentage of CCR of the NEP for each State.

10.2 Reconciliation to estimates

Any adjustments to Commonwealth NHR funding arising from the Reconciliation process are spread equally across payments for a subsequent quarter (clause B62).

Figure 12 reflects the intended Reconciliation and adjustment timeline under the Agreement:

- For the six-month Reconciliation period July to December 2016, adjustments to Commonwealth payments are spread equally over the three months July to September 2017.
- For the annual period July to June 2017, adjustments to Commonwealth payments are scheduled to be spread equally over the three months January to March 2018.

Figure 12: Intended Reconciliation and adjustment timeline under the Agreement (six-month and annual respectively)

2016-17												2017-18											
Reconciliation period												Adjustment											
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J

The Administrator reserves the right to alter the adjustment timeline where circumstances make it difficult to achieve without compromising the quality of the calculations.

These timeframes may vary depending on:

- timeliness of data submitted to the IHPA and the Administrator;
- complexity of Reconciliation;
- timing of the Commonwealth Treasurer's issuance of the Federal Financial Relations (National Health Reform Payments) Determination; or
- other factors.

Jurisdictions are advised accordingly whenever there is a change in the timelines.

10.3 Six-month adjustment

The six-month actual hospital activity data is reconciled against the actual funding that was paid in the first half (i.e. July-December) of the relevant financial year. The funding attributable to the relevant six-month NWAU actual is calculated using the method below.

Reconciled NWAU

a) For each LHN in a state, the sum of the actual service category payments for each LHN based on estimated NWAU (relating to July to December) is calculated.

b) For each LHN in a state, the amount that should have been paid for each service category based on the six-month actual NWAU (relating to July to December) is calculated by multiplying by the NEP and the Commonwealth contribution percentage as at December of the relevant financial year.

Model

c) The difference between the Commonwealth contribution to each LHN paid based on estimates identified in step a) and the Commonwealth contribution to each LHN based on actuals identified in step b) is the six-month reconciliation adjustment to be effected.

d) If the Reconciliation adjustment identified in step c) is a negative amount that would reduce that LHN's Commonwealth NHR funding for the relevant three month period to below zero, the Reconciliation adjustment cannot be fully effected in the identified (three month) period. In these circumstances, the Administrator has determined that the Reconciliation adjustment period for the impacted LHN is extended until the Reconciliation adjustment can be recovered from future months' payments to that LHN. Any amount of six-month Reconciliation adjustment yet to be recovered at the time of the annual Reconciliation is incorporated into the annual Reconciliation adjustment (see annual process below).

e) The amount for each LHN identified in step c) (and step d), if required is spread evenly over the relevant adjustment period with any rounding differences made up in the final month of the adjustment period.

f) Other adjustments to Commonwealth NHR funding may also be made, as outlined in Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*. These may include changes to LHN NWAU estimates, NEC and NEP Determinations and/or other adjustments as allowed for under the Agreement.

10.4 Annual adjustment

The annual actual NWAU is reconciled to the annual estimated NWAU for each LHN in every State. The CCR of NEP is then recalculated using the annual actual NWAU. The following steps enable the calculation of the annual Reconciliation adjustment.

Reconciled NWAU

a) For each LHN in a State, the amount that should have been paid for each service category based on the annual actual NWAU is calculated.

b) The National Funding Cap is applied to Commonwealth NHR funding based on actual activity (Chapters 7.3 *Activity Based Funding – based on actuals* and 8.2 *National Funding Cap*). The Administrator determines the final Commonwealth Funding Entitlement for the relevant financial year at this time, inclusive of the Funding Cap, Redistribution and the Safety and Quality Adjustment.

Model

c) The annual Reconciliation adjustment, being the difference between the amounts calculated for each LHN under the Commonwealth Funding Entitlement in step b) and what was already paid to the LHN (including any payments made during the six-month reconciliation process) is determined.

d) As with the six-month process, if the amount identified in step c) is a negative amount that would reduce an LHN's Commonwealth NHR funding for the relevant three month period to below zero, the Reconciliation adjustment cannot be fully effected in the identified (three month) period. In these circumstances, the Administrator has determined that the Reconciliation adjustment period for that LHN is extended until the Reconciliation adjustment can be recovered from future months' payments to the LHN.

e) The amount for each LHN identified in step c) (and step d), if required) is spread evenly over the relevant adjustment period with any rounding differences made up in the final month of the adjustment period. If an outstanding amount exists at the end of the period, this amount is recovered from another LHN within the state or be repaid by the State. The Administrator seeks advice from the state on the preferred recovery mechanism if this circumstance arises.

f) Other adjustments to Commonwealth NHR funding may also be made, as outlined in Chapter 9 *Adjustments to Commonwealth National Health Reform Funding*, under the Agreement. These may include changes to LHN NWAU estimates, NEC and NEP Determinations and/or other adjustments as allowed for under the Agreement. For transparency purposes, adjustments resulting from the annual Reconciliation calculation are identified separately in the funding model and advice to the Commonwealth Treasurer.

g) The annual actual NWAU for the reconciled financial year is also used as the base year to recalculate the relevant financial year funding entitlement (Chapter 7.4 *Growth and Negative Growth*).

11. Back-casting

Back-casting is a requirement under clause A40, where the effect of any significant changes to classification or costing methodologies determined by IHPA must be back-cast to the year prior when the Administrator is calculating growth funding.

The back-casting requirement is intended to ensure that changes between years are correctly accounted for and Commonwealth NHR funding is not adversely impacted by known changes in the national pricing and cost model over consecutive years. This includes changes to, between and within ABF and Block funding streams.

Operationally, this means any significant methodology changes for the relevant financial year are applied to the base year data to calculate a new base that is consistent with the relevant financial year calculations, ensuring a more appropriate estimate of growth funding.

ABF back-casting and growth calculations and recalculations are conducted at the stages identified in Figure 13 below.

Figure 13: Back-casting calculation stages

1. Based on estimated activity for both the base year and relevant financial year (years 0 and 1).
2. Based on actual annual activity for the base year (year 0) and estimated activity for the relevant financial year (year 1).
3. Based on actual annual activity for both the base year and relevant financial year (years 0 and 1).

The Administrator's approach to back-casting varies depending on the timing of the calculation (i.e. base year activity being estimates or actuals). The variations in the approach are discussed further in Chapter 11.1 *Back-casting for estimates* and 11.2 *Back-casting for actuals*.

The Administrator works with IHPA and jurisdictions to ensure the Commonwealth NHR funding calculation in the growth period is robust and reflective of all developments in costing and pricing methodologies.

11.1 Back-casting for estimates

The IHPA determines back-casting multipliers for each State and service category, where relevant, in its NEP and NEC Determinations. This information is used to calculate the Commonwealth NHR funding, based on estimated activity levels (i.e. stage 1 in Figure 13).

See Example 7 for a worked example of the calculation approach of back-casting using the back-casted multipliers.

Example 7: Back-casting example

The Acute admitted service category is shown in the example. The same process is conducted for each service category with ABF and Block funding streams, individually for each State.

1. **Gather relevant information** for each State and each service category. This is conducted initially using estimated activity and then actual annual hospital activity data.

	Data source	
2016-17 ABF Acute CW funding (at June 2017)	*Administrator's calculations*	= $ 2,283.0 million
V1, 2017-18 ABF Acute NWAU	*S/T advice*	= 1,250,264 estimate
P1, 2017-18 NEP	*IHPA*	= $ 4,910
V0, 2016-17 ABF Acute NWAU	*S/T advice*	= 1,175,418 estimate
P0, 2016-17 NEP	*IHPA*	= $ 4,883
Back-casted P0, Back-casted 2016-17 NEP in 2017-18	*IHPA*	= $ 4,833
2017-18 Acute back-casting volume multiplier	*IHPA*	= 0.9939

2. **Apply the back-casting volume multiplier** for each service category and State to the base year NWAU. This ensures the base year and relevant financial year NWAU are on a like-for-like basis (the effect of identified changes between the relevant years is negated). The adjusted NWAU for the base year (incorporating the back-casting multiplier) is used only for growth calculation purposes, not to adjust previous year funding.

V0 2016-17 ABF Acute NWAU	*x*	2017-18 Acute back-casting multiplier	=	2016-17 ABF Acute NWAU (post multiplier) - *updated V0*
1,175,418	*x*	0.9939	=	1,168,248

3. **Where no back-casting volume multipliers have been provided** the Administrator applies a multiplier of '1' for each relevant service category and State. Where no multiplier has been provided, indicates that IHPA has determined that any pricing or costing specification changes between years are not 'significant' enough to warrant a back-casting multiplier to be applied to growth calculations.

4. **Calculate growth funding as per Chapter 7 *Activity Based Funding*, incorporating the back-casted price component**.
   A high-level representation of the growth calculation approach is as follows.

The 2017-18 Acute admitted funding allocation would be calculated as:
$2,283.0m + 45% x [(1,250,264 x $4,910) – (*1,168,248* x *$4,833*)] = **$2,504.7m**

5. **If IHPA releases updated or new back-casting multipliers** during the course of the year, the growth calculations set out above are redone.

Note: totals may not equal the sum of components due to rounding

11.2 Back-casting for actuals

Following the annual Reconciliation, the back-casting multipliers for each category are replaced in the growth calculation by actual back-casted figures. These are calculated by applying the NWAU calculator of the relevant financial year (e.g. 2017-18 NWAU calculators) to the base year actuals (e.g. 2016-17 annual hospital activity data).

There are two parts in the calculation process once actual annual data are received – one in relation to Reconciliation activities for that year (e.g. 2016-17), and the other for growth calculations for the subsequent year (e.g. 2017-18). The NWAU calculation steps are the same for both parts; however the NWAU calculation itself for each part is a separate process. The NWAU calculation in relation to each part is highlighted in Figures 14 and 15 below, using 2016-17 and 2017-18 as an example.

Figure 14: Part 1 (2016-17 Reconciliation activities)

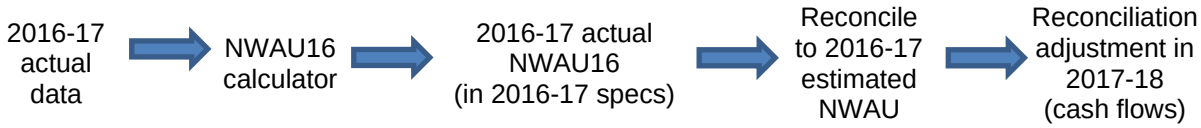
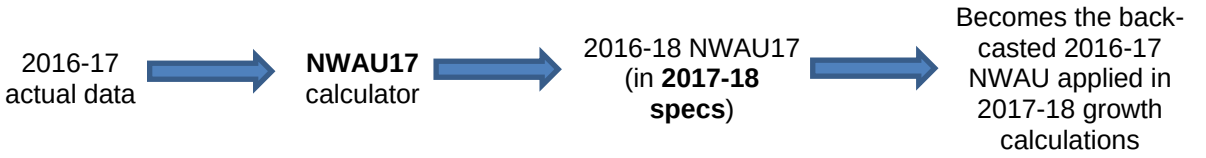


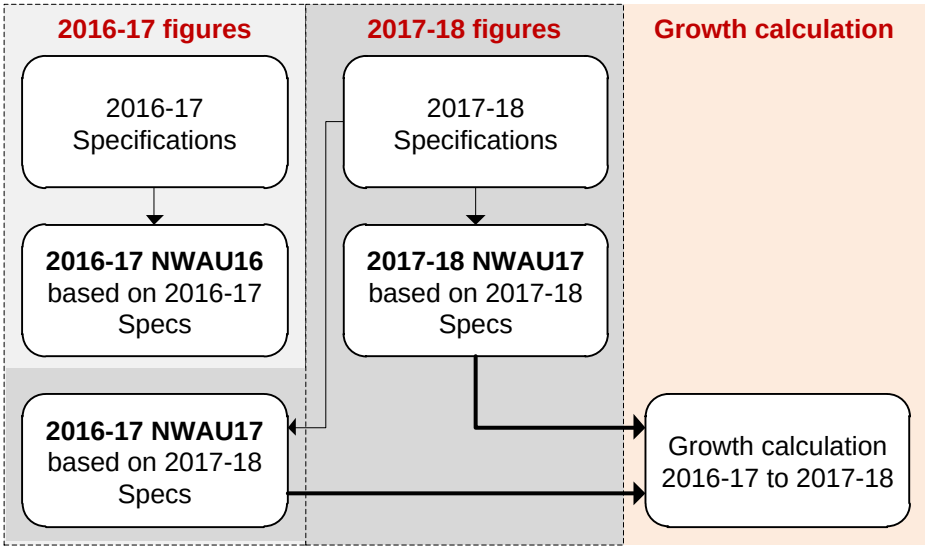
Figure 15: Part 2 (2017-18 growth calculation process)

The actual 2016-17 data are processed through the NWAU17 calculator to determine the 'value' of the 2016-17 activity as if it were delivered in 2017-18. This process ensures any scope changes between 2016-17 and 2017-18 are captured and applied to the complete 2016-17 data.



The back-casting and growth calculation based on annual actual hospital activity is illustrated in Figure 16 below.

Figure 16: Back-casting and growth calculation for actual hospital activity



11.3 Significant changes between financial years

Between financial years, there may be significant changes made to ABF classification systems or counting methodology that would affect the NWAU calculation but are not apparent in the base year data. The Administrator, in line with clause A40, is required to back-cast these changes in the Commonwealth NHR growth calculation.

The approach to back-casting may vary depending on the available information, summarised in Table 2.

Table 2: Administrator's approach to back-casting

Scenario	Approach to back-casting	Example
New adjustment introduced in the pricing models	If episodes eligible for the adjustment can be identified in base year data, the change is back-cast by application of the relevant NWAU calculator to the base year data. Alternatively, base year data is collected and reported by states and territories prior to implementation of change (shadow reporting). This data enables identification of episodes eligible for the adjustment and to apply the relevant NWAU calculator over the base year data. Otherwise, if shadow reporting is not available for the base year, a 'conversion factor' may be applied alongside the base year activity data prior to the application of the relevant NWAU calculator.	Emergency care age adjustment Treatment remoteness adjustment
Change in classification	If base year data can be appropriately reclassified, it is back-cast by applying the new classification and the relevant NWAU calculator over the base year data. Alternatively the base year data is collected and reported by states and territories prior to implementation of change (shadow reporting). This data would enables identification of episodes eligible for the adjustment and to apply the relevant NWAU calculator over the base year data. Otherwise, if shadow reporting is not available, a 'conversion factor' may be applied alongside the base year activity data prior to the application of the relevant NWAU calculator.	New version of AR-DRG Existing Tier 2 clinic split into new clinics Change in clinic definition (e.g. expanded definition of what is in-scope) Change in counting rules (e.g. from individual events to once per month)

Scenario	Approach to back-casting	Example
Moving services from block to ABF	If services moved to ABF can be identified in the base year data, the change is back-cast by moving the Commonwealth Block funding to ABF and including the associated activity for the services when back-casting the base year data. Alternatively the base year data is collected and reported by states and territories prior to implementation of change (shadow reporting). This data would enable the identification of services to be moved from Block to ABF and to apply the relevant NWAU calculator over the base year data. If data is not available or not able to be reliably sourced on a nationally consistent basis, back-cast by setting the Commonwealth Block funding for these services to zero and use a base year NWAU value of zero when calculating Commonwealth ABF growth funding.	Moving small rural hospitals from block to ABF. Block funded services moving from block to ABF
Moving services from ABF to Block	If the costs of the services moving to Block can be quantified for the base year, back-cast by moving the Commonwealth ABF amount to Block and calculate the efficient growth as the difference between the relevant year NEC and back-casted NEC for the base year. Set the NWAU for the actual hospital activity data for these services to zero. Alternatively the base year data is collected and reported by states and territories prior to implementation of change (shadow reporting). This data would enable the costs of services to be moved from ABF to Block to be quantified and calculation of Commonwealth Block growth funding. If NEC amounts are not available or cannot be reliably sourced on a nationally consistent basis, back-cast by assuming zero base for Block funding, and subtract the total ABF amount associated to these services from ABF.	

The Administrator uses actual hospital activity or proxy data to implement back-casting. Where no actual or proxy data is available for the base year, the Administrator uses a back-cast figure of zero.

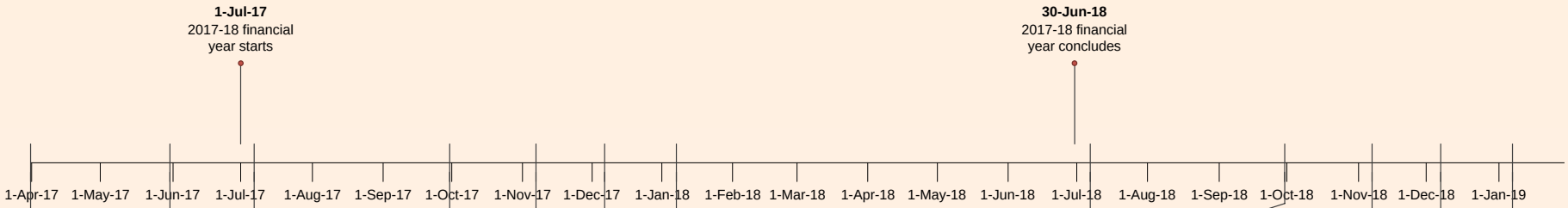
The proxy data may be a ‘conversion factor’ calculated by the Administrator, provided by the State or the IHPA.

12. Timeline

The timeline shows each stage of the Administrator’s processes, and key data submission points by jurisdictions. It highlights the iterative nature of the Administrator’s calculations and the stages of each growth calculation (i.e. estimates to estimates, actuals to estimates and actuals to actuals).

TIMELINE OF THE ADMINISTRATOR'S NHR FUNDING CALCULATIONS

RELATING TO THE 2017-18 FINANCIAL YEAR



31-Mar-17
2017-18 *estimated* S&T aggregate service volumes due

31-May-17
2017-18 *confirmed* S&T aggregate & *estimated* LHN service volumes due

7-Jul-17
Step 14
2017-18 CW contribution commences based on:

- Growth calculation based on 2017-18 estimate (provided in May 2017) and the final 2016-17 estimate (as at June 2017).
- 2017-18 state-based Soft Cap applied to payments.

30-Sep-17
2016-17 annual actual hospital services data due

7-Nov-17
Data Conditional Payment applied if 2016-17 data not received by 30 Sep 2017

7-Dec-17
Data Conditional Payment applied if 2016-17 data not received by 31 Oct 2017

7-Jan-18
2017-18 CW contribution adjustment occurs based on:

- 2016-17 annual reconciliation adjustment against estimate, and
- Growth calculation adjustment based on 2017-18 estimate (as at Dec 2017) and the final 2016-17 actual reconciliation.
- 2017-18 state-based Soft Cap re-calculated and applied to payments.

Note: this timing is dependent on the Treasurer's Determination

7-Jul-18
2018-19 CW contribution commences based on:

- Growth calculation based on 2018-19 estimate (provided in May 2018) and the final 2017-18 estimate (as at June 2018).
- 2018-19 state-based Soft Cap applied to payments.

30-Sep-18
2017-18 annual actual hospital services data due, including Safety and Quality events

7-Nov-18
Data Conditional Payment applied if 2017-18 data not received by 30 Sept 2017

7-Dec-18
Data Conditional Payment applied if 2017-18 data not received by 31 Oct 2017

7-Jan-19
2018-19 CW contribution adjustment occurs based on:

- 2017-18 annual reconciliation adjustment against estimate.
- Growth calculation adjustment and 2017-18 National Funding Cap applied, and re-distribution amounts calculated and paid if applicable based on the final 2017-18 actual reconciliation and 2016-17 actual reconciliation (conducted in Sep 2017), including the Safety and Quality Adjustment. *[Note, this is the first opportunity where both years of annual actuals can be used to calculate growth].*
- Growth calculation adjustment based on 2018-19 estimate (as at Dec 2018) and the final 2017-18 actual reconciliation.
- 2018-19 state-based Soft Cap re-calculated and applied to payments.

Note: this timing is dependent on the Treasurer's Determination

Key:
In relation to 2016-17
In relation to 2017-18
In relation to 2018-19

13. Reporting

The Administrator undertakes a number of reporting mechanisms to enable transparency of the funding for public hospital services, including an annual report and monthly reports.

Section 240 of the Act requires the Administrator to provide monthly reports to the Commonwealth and each State, and to make these publicly available. The monthly reports contain detail for the month and year-to-date funding and payments into and out of the State Pool Accounts and State Managed Funds paid to LHNs, including the NWAU funded. These are described by Commonwealth and States contributions and by service category.

The Administrator also provides payment advice to the Commonwealth Treasurer as needed to enable cash payments from the Commonwealth into the NHFP. The purpose for the Administrator's advice to the Commonwealth Treasurer is described in further detail below.

13.1 Advice to the Commonwealth Treasurer

The Administrator's advice to the Commonwealth Treasurer is provided for specific purposes, including:

- the Commonwealth Budget, based on initial estimates of hospital activity from States, in April each year;
- Payment Advice for the relevant financial year, based on confirmed estimates of hospital activity from States. The Payment Advice can be updated monthly;
- MYEFO; and
- the annual Treasurer's Determination of public hospital funding, based on Reconciliation of actual hospital activity for the prior year. This advice is issued in the second half of the following financial year.

As part of the Administrator's Payment Advice to the Commonwealth Treasurer, information on Funding Cap entitlements and adjustment is provided. This outlines the States' Uncapped Commonwealth Funding Entitlement and how these are impacted by the National Funding Cap and Soft Cap.

14. Dependencies

For the successful calculation of Commonwealth Funding Entitlement process in a timely manner there are external dependencies; these are outlined throughout the document and summarised below.

Entity	Component	Required for	Required by	Document location
Commonwealth Treasury	Public Health funding for each State	Public Health funding	– Prior to commencement of the year, and – When Public Health funding alters.	Chapter 5
IHPA	NEC Determination	Block funding	– Prior to commencement of the year, and – If the NEC Determination alters.	Chapter 6
IHPA	NEP Determination	ABF	– Prior to commencement of the year, and – If the NEP Determination alters.	Chapter 7
IHPA	Back-casting information for each relevant funding stream and service category	ABF and Block funding	– Prior to commencement of the year, and – If the NEC and NEP Determination(s) alters.	Chapter 11
States and territories	LHN and aggregate NWAU estimates by service category	ABF Funding Cap	– Prior to commencement of the year, and – If the NWAU alters.	Chapters 7 and 8
States and territories	LHN annual actual hospital activity data by service category	ABF	– By 30 September of the following financial year	Chapters 7, 8 and 9.5
States and territories	Safety and Quality events	Safety and Quality Adjustment	– By 30 September of the following financial year	Chapter 9.4
Commonwealth Treasurer	Treasurer's Determination	Reconciliation	– By 15 May to enable payment within the following financial year	Chapters 9.3 and 10

15. National Health Reform Agreement & Addendum Review Considerations

The pricing for safety and quality funding arrangements from 2017-18 include additional processes in the way the Commonwealth NHR funding is calculated for hospital activity delivered in States. The Addendum provides clarity for a pricing mechanism for Sentinel Events, and guidelines for the development of pricing mechanisms for HACs and Avoidable Hospital Readmissions. The development of these processes requires additional consideration by the IHPA and COAG Health Council.

15.1 Hospital Acquired Complications

Under clauses I65 to I69, the Commonwealth and States will develop, in consultation with the Australian Commission on Safety and Quality in Health Care (ACSQHC), the IHPA and the Administrator, a comprehensive pricing and funding model to incentivise safety and quality. This includes adjusting funding for services that include a HAC, to be introduced from 1 July 2018.

The preferred pricing and funding option for HACs will be shadow priced in the 2017-18 financial year. The IHPA will develop a preliminary report assessing the shadow implementation, including the impact of the preferred model on funding, data reporting, clinical information systems, and specific population and peer hospital groups. The preliminary report will be publicly consulted on, with the final report to be submitted to COAG Health Council by 30 November 2017.

The ACSQHC will review and update the HAC List agreed under clause I69.

15.2 Avoidable Hospital Readmissions

The process for developing a pricing mechanism for Avoidable Hospital Readmissions is outlined in clauses I70 to I74, with advice to be provided to the COAG Health Council by November 2017.

The ACSQHC will develop a list of clinical conditions that arise from complications of the management of the original condition, which can be considered Avoidable Hospital Readmissions, including identifying suitable condition-specific timeframes for each of the identified conditions.

The November 2017 advice to COAG Health Council from the IHPA and ACSQHC, together with the Commonwealth and States, will include:

- a nationally consistent definition for Avoidable Hospital Readmissions; and
- a proposal for refining the risk adjustment methodology and undertaking a peer review process in 2017 to ensure the methodology is fit for purpose.

Pricing for Avoidable Hospital Readmissions will be implemented no earlier than 1 July 2018 (clause I74).

16. Appendices

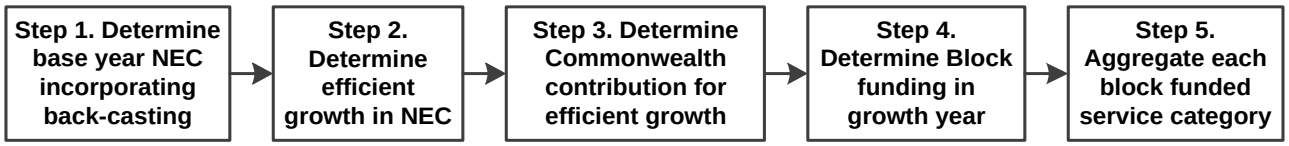
The following appendices have been included:

- Appendix A: Methodology for calculating components of Commonwealth National Health Reform funding
- Appendix B: Growth Planning Tool
- Appendix C: Relevant National Health Reform Agreement Clauses
- Appendix D: Glossary
- Appendix E: Abbreviations and Acronym

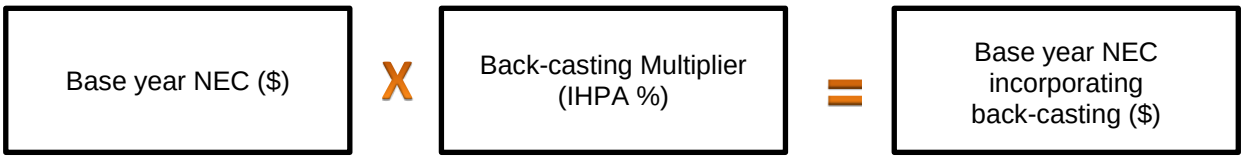
Appendix A: Methodology for calculating components of Commonwealth National Health Reform funding

A1. Block funding calculation

The Block funding calculation steps are summarised below. Each step is then described in terms of the relevant inputs and outputs.

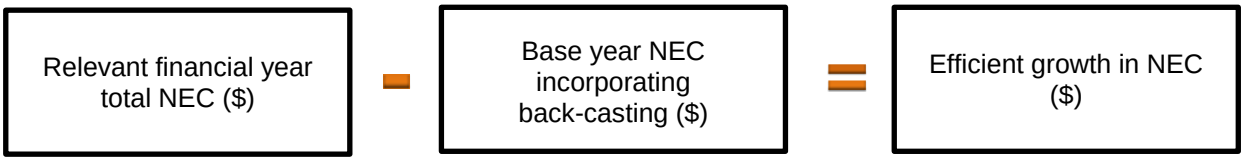


Step 1 - Determine NEC incorporating back-casting

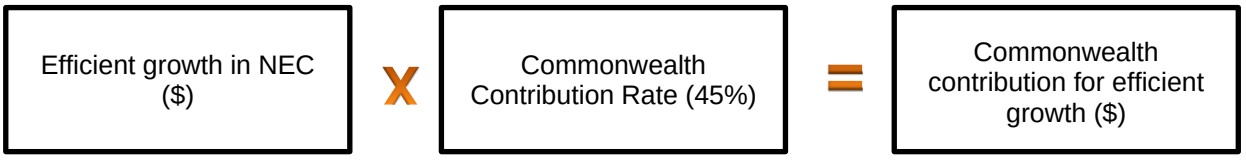


Step 1a - Determine NEC incorporating back-casting for Small Rural hospitals

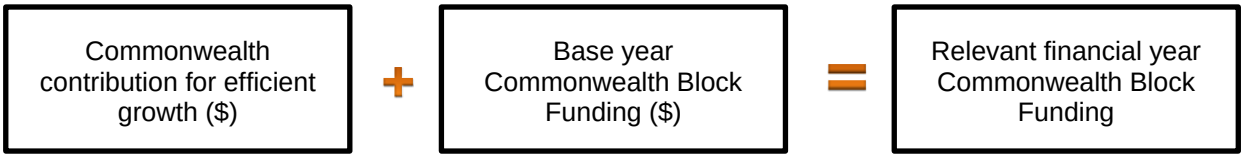
Step 2 - Determine efficient growth in NEC



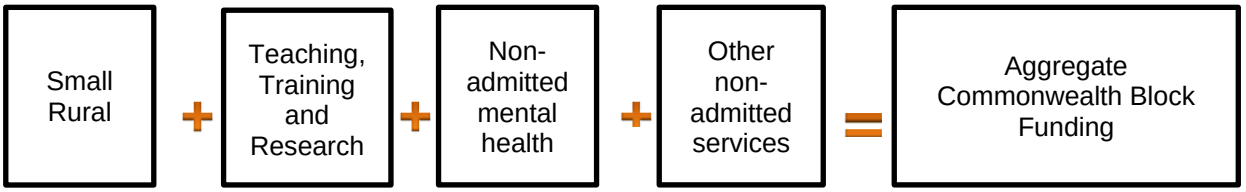
Step 3 - Determine Commonwealth contribution for efficient growth [service category level]



Step 4 - Determine Block funding in relevant financial year [service category level]

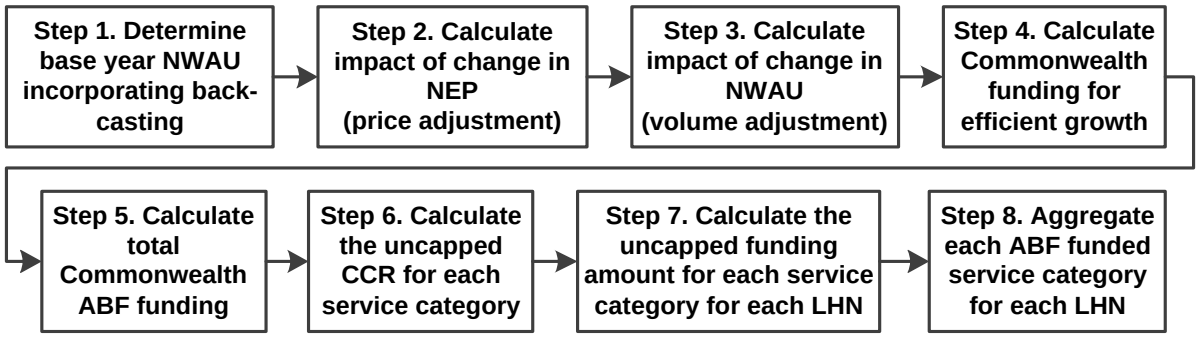


Step 5 - Aggregate each Block funded service category [state or territory level]

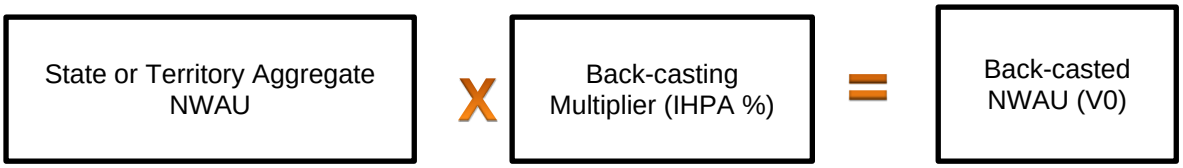


A2. Activity Based Funding calculation

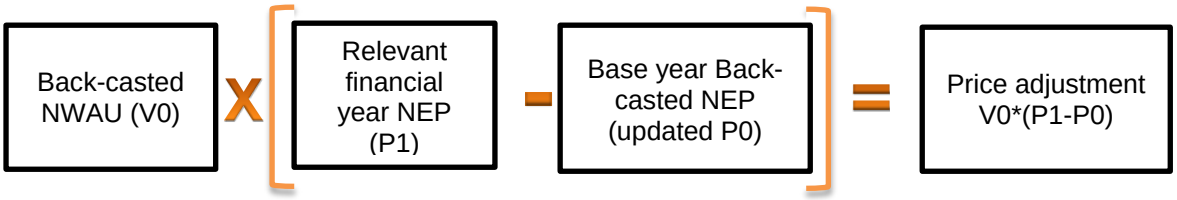
The ABF funding calculation steps are summarised below. Each step is then described in terms of the relevant inputs and outputs.



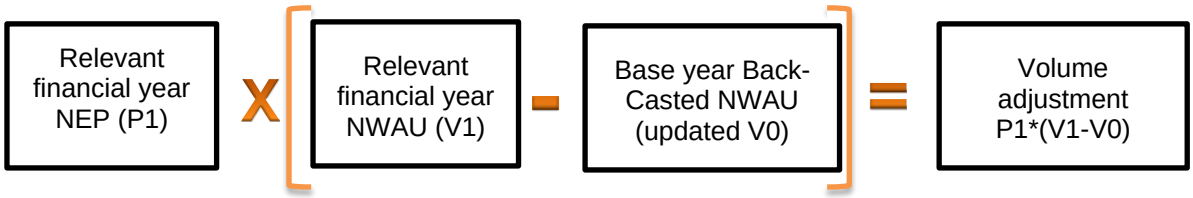
Step 1 - Calculate base year NWAU incorporating back-casting [service category level]



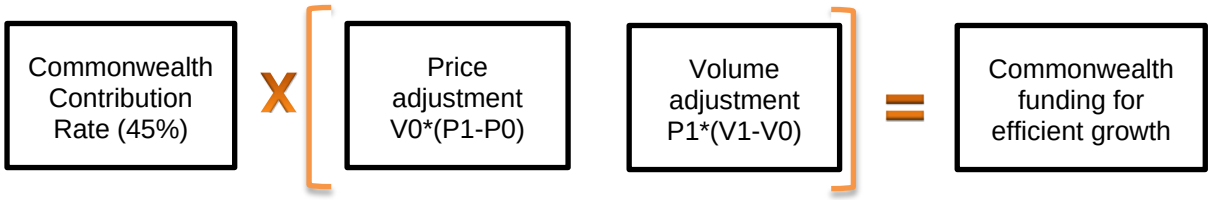
Step 2 - Calculate impact of change in NEP [service category level]



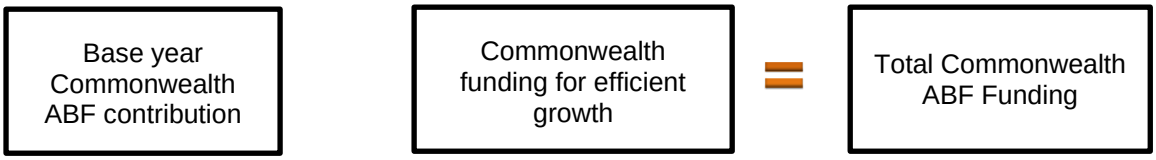
Step 3 - Calculate impact of change in NWAU [service category level]



Step 4 - Calculate Commonwealth funding for efficient growth [service category level]



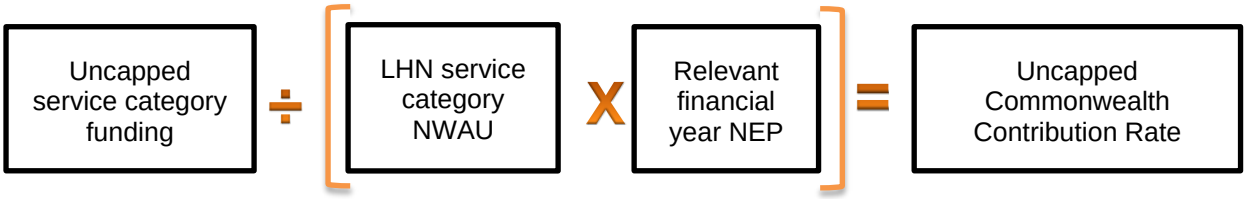
Step 5 - Calculate total Commonwealth ABF funding [service category level]



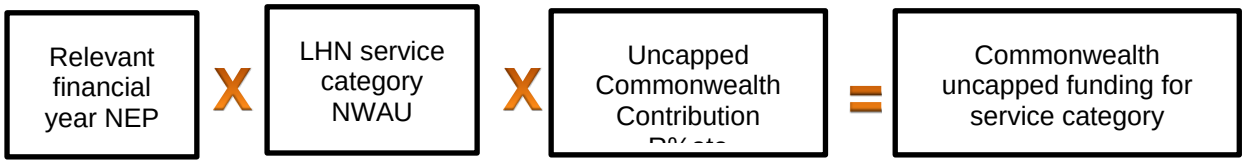
Step 4 and 5 can also be expressed as:

Base year CW funding + efficient growth % x (V1 x P1 - updated V0 x updated P0)

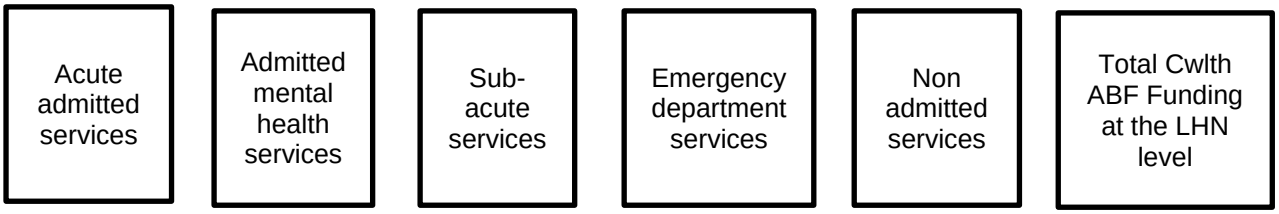
Step 6 - Calculate the Commonwealth Contribution Rate for each service category [service category level]



Step 7 - Calculate the uncapped funding amount for each service category [LHN level]



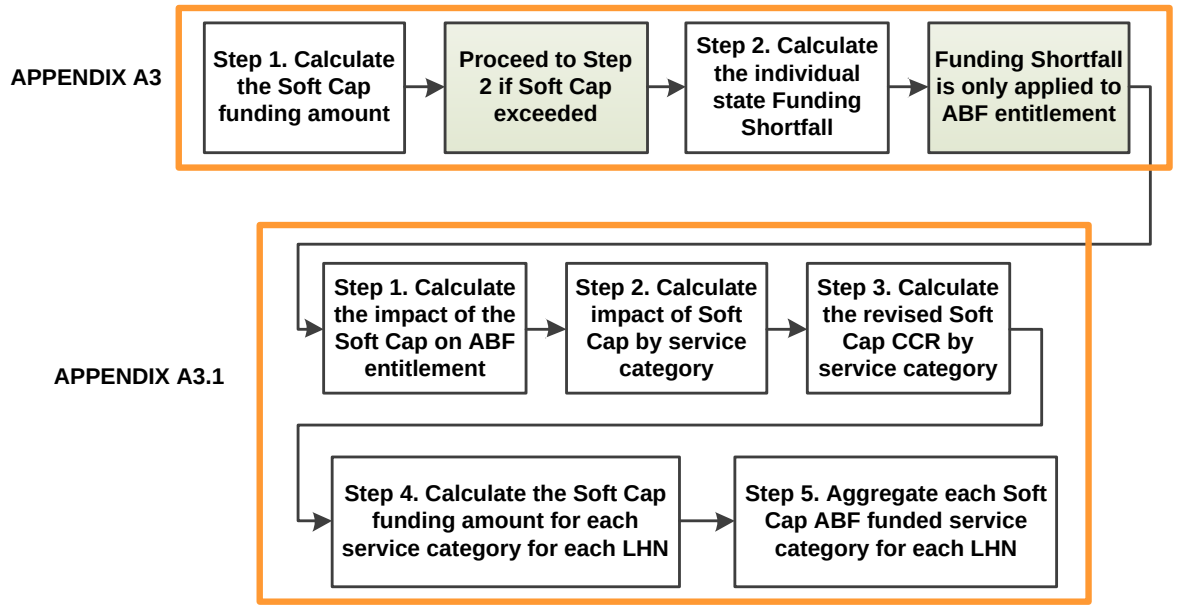
Step 8 - Aggregate each ABF funded service category for each LHN [LHN level]



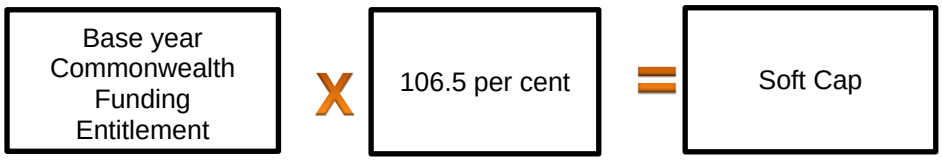
If a jurisdiction does not provide LHN NWAU estimates by service category, the LHN ABF is calculated based on the aggregate NWAU estimates provided.

A3. Soft Cap calculation

The Soft Cap calculation steps are summarised below. Each step is then described in terms of the relevant inputs and outputs. Appendix A3.1 describes the calculation steps required in the event the Soft Cap is exceeded.



Step 1 - Calculate the Soft Cap funding amount [state or territory level]



Base year Commonwealth Funding Entitlement is the sum of ABF, Block and Public Health funding for the prior year.

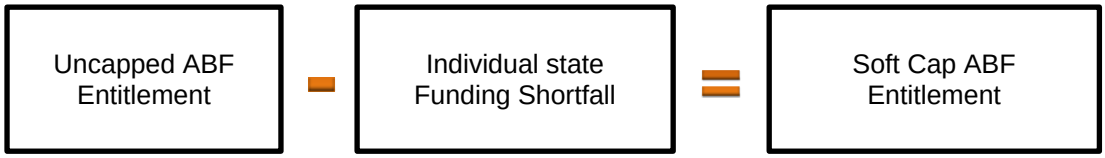
If the Uncapped Commonwealth Funding Entitlement is less than the Soft Cap, Step 2 is not required. The Uncapped Commonwealth Funding Entitlement is the sum of ABF, Block and Public Health funding for the relevant financial year.

Step 2 - Calculate the individual state Funding Shortfall, when Uncapped Commonwealth Funding Entitlement exceeds the Soft Cap [state or territory level]

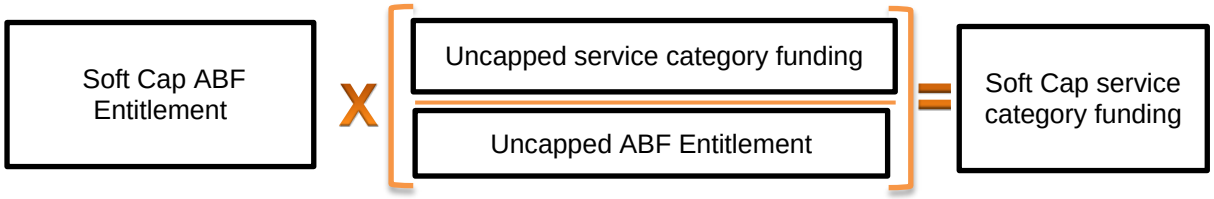
A3.1 If the Soft Cap is exceeded

The Funding Cap shortfall is applied to the ABF funding only. The Funding Shortfall is applied to the State's LHNs as depicted in the diagram below.

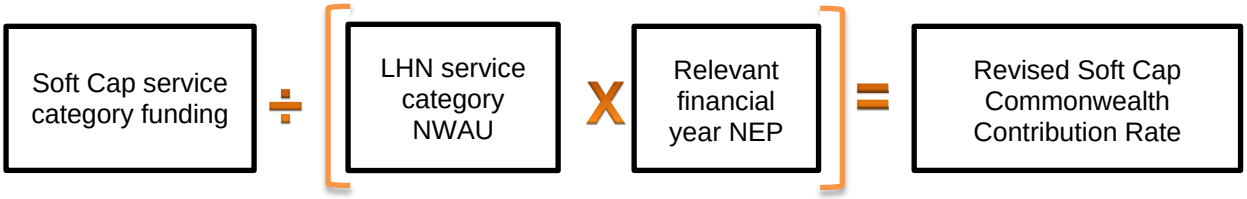
Step 1 - Calculate impact of the Soft Cap on ABF Entitlement [state or territory level]



Step 2 – Calculate impact of the Soft Cap on individual service category funding [service category level]

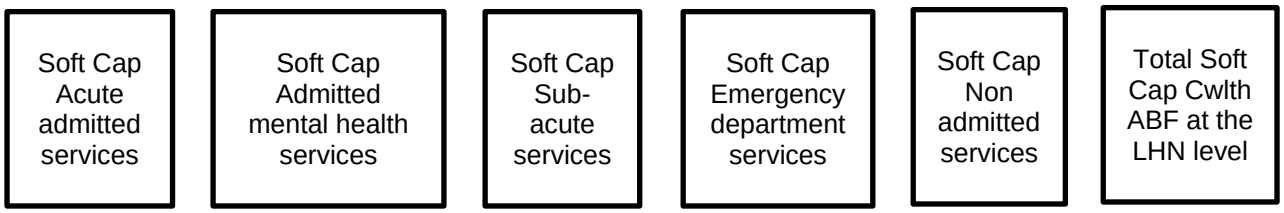


Step 3 - Calculate the revised Soft Cap Commonwealth Contribution Rate for each service category [service category level]



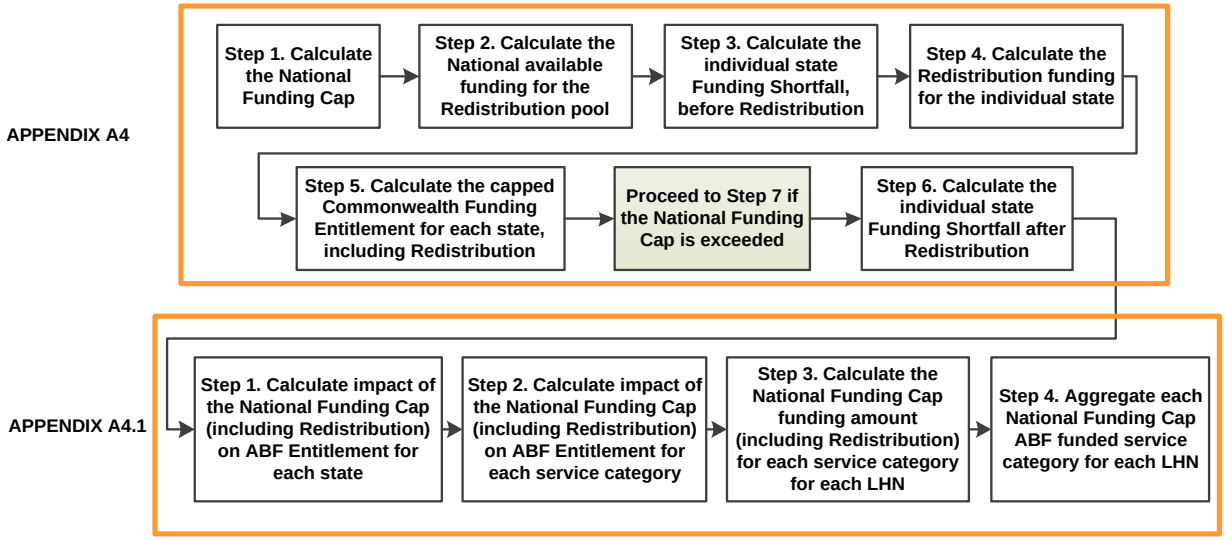
Step 4 - Calculate the Soft Cap funding amount for each service category [LHN level]

Step 5 - Aggregate each Soft Cap ABF funded service category for each LHN [LHN level]

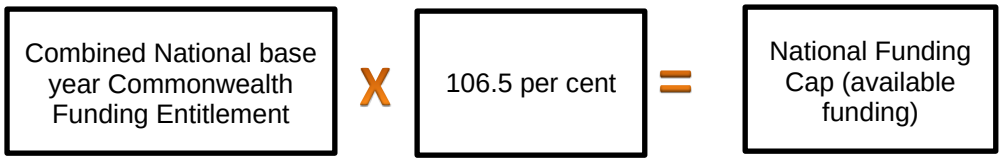


A4. National Funding Cap calculation

The National Funding Cap calculation steps are summarised below. Each step is then described in terms of the relevant inputs and outputs. Appendix A4.1 describes the calculation steps required in the event the National Funding Cap is exceeded.



Step 1 - Calculate the available funding under the National Funding Cap [national level]

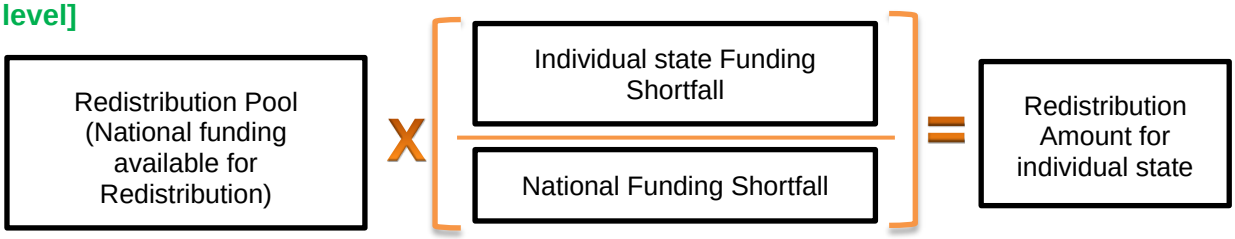


Step 2 - Calculate the Redistribution Pool [national level]

The Redistribution Pool is the sum of Individual State Funding available for Redistribution for all States below the Soft Cap, where:

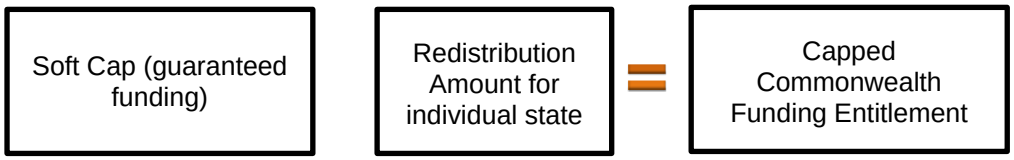
Step 3 - Calculate the individual state Funding Shortfall before Redistribution, for states exceeding the Soft Cap [state or territory level]

Step 4 - Calculate the Redistribution funding for the individual state [state or territory level]

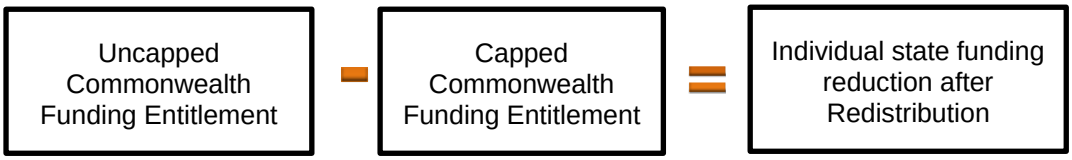


National Funding Shortfall is the sum of Individual State Funding Shortfall for all States exceeding the Soft Cap.

Step 5 - Calculate the capped Commonwealth Funding Entitlement for the individual state [state or territory level]



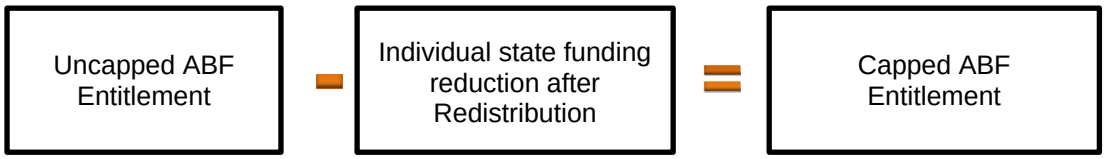
Step 6 - Calculate the individual State funding reduction after Redistribution [state or territory level]



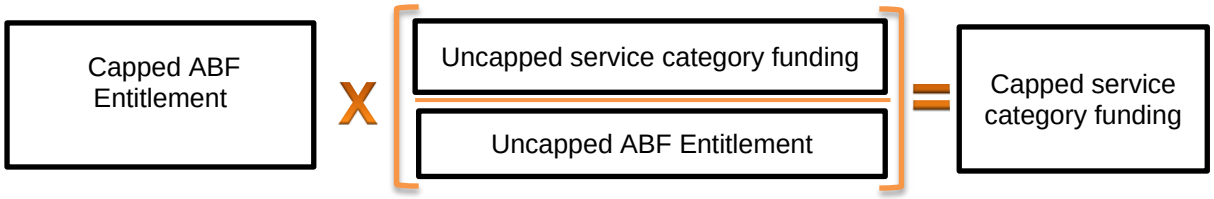
A4.1 If the National Funding Cap is exceeded

The application of the Redistribution Pool and Funding Shortfall is applied to the State's LHNs as depicted in the diagram below, noting that the impact of the National Funding Cap can only be applied to ABF services.

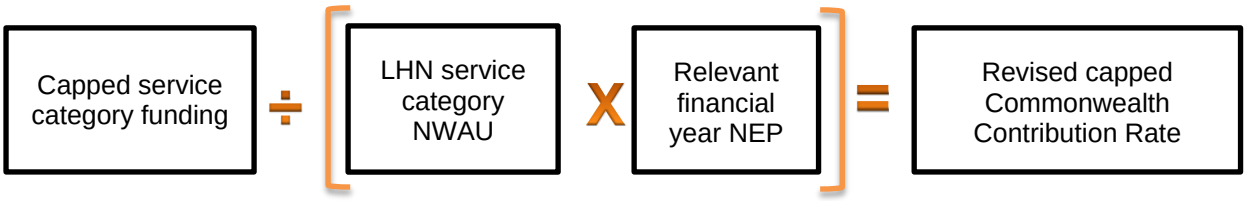
Step 1 - Calculate impact of the National Funding Cap (including Redistribution) on ABF Entitlement [state or territory level]



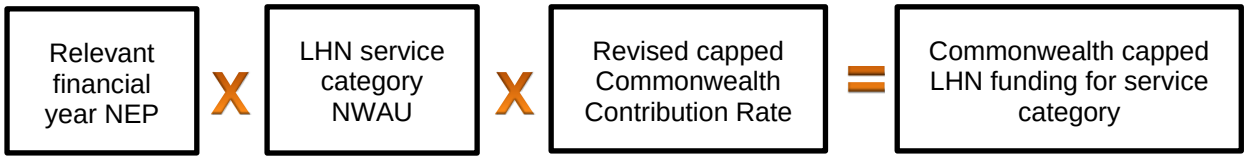
Step 2 - Calculate impact of the National Funding Cap (including Redistribution) on individual service category funding [service category level]



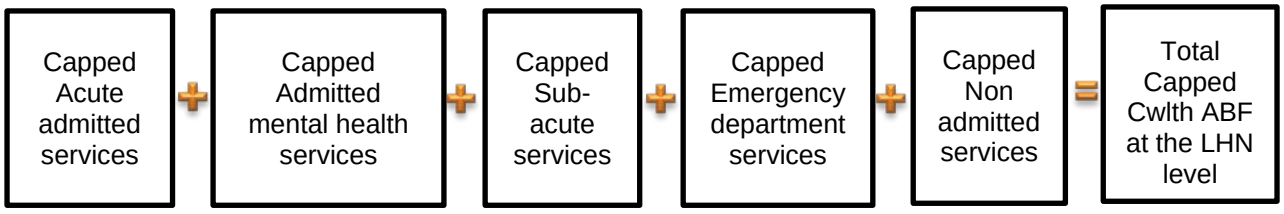
Step 3 - Calculate the revised capped Commonwealth Contribution Rate for each service category [service category level]



Step 4 - Calculate the National Funding Cap funding amount (including Redistribution) for each service category [LHN level]



Step 5 - Aggregate each capped ABF funded service category for each LHN [LHN level]



The total Commonwealth Funding Entitlement (capped ABF, Block and Public Health) forms the base for the following relevant financial year calculation.

A5 Pricing for Quality and Safety (PQS) examples

Figures are illustrative only.

Base Case (No HAC Adjustments)				
	2016-17	2017-18	2018-19	2019-20
Price (NEP)	$5,000	$5,000	$5,000	$5,000
Back-casted NEP	$5,000	$5,000	$5,000	$5,000
Growth year NWAUs	1,000,000	1,060,000	1,121,000	1,180,000
PQS NWAU deduction		0	0	0
PQS Adjusted NWAUs		**1,060,000**	1,121,000	1,180,000
Back-casted NWAUs pre-PQS adjustment	1,000,000	1,060,000	1,121,000	
PQS NWAU deduction	0	0	0	
PQS adjusted NWAU Base for following year	**1,000,000**	1,060,000	1,121,000	
NWAU Growth		**60,000**	61,000	59,000
Uncapped Funding	$2,000,000,000	$2,135,000,000	$2,267,250,000	$2,400,000,000
Uncapped Funding Growth		6.75%	6.44%	5.86%
Cap Amount		$2,130,000,000	$2,268,450,000	$2,414,621,250
Cap Reduction		$5,000,000	$0	$0
Final Funding	$2,000,000,000	$2,130,000,000	$2,267,250,000	$2,400,000,000
Final Funding Growth		6.50%	6.44%	5.86%

Note: In the base case, there are no safety and quality adjustments. This is included for comparative purposes.

Example: improvement in safety and quality				
	2016-17	2017-18	2018-19	2019-20
Price (NEP)	$5,000	$5,000	$5,000	$5,000
Back-casted NEP	$5,000	$5,000	$5,000	$5,000
Growth year NWAUs	1,000,000	1,060,000	1,121,000	1,180,000
PQS NWAU deduction		-9,000	-8,000	-7,000
PQS Adjusted NWAUs		1,051,000	1,113,000	1,173,000
Back-casted NWAUs pre-PQS adjustment	1,000,000	1,060,000	1,121,000	
PQS NWAU deduction	-10,000	-9,000	-8,000	
PQS adjusted NWAU Base for following year	990,000	1,051,000	1,113,000	
NWAU Growth		61,000	62,000	60,000
Uncapped Funding	$2,000,000,000	$2,137,250,000	$2,269,500,000	$2,403,450,000
Uncapped Funding Growth		6.86%	6.55%	5.95%
Cap Amount		$2,130,000,000	$2,268,450,000	$2,415,899,250
Cap Reduction		$7,250,000	$1,050,000	$0
Final Funding	$2,000,000,000	$2,130,000,000	$2,268,450,000	$2,403,450,000
Final Funding Growth		6.50%	6.50%	5.95%
		+0	**+1,200,000**	**+3,450,000**

Note: In this example, safety and quality measures have improved over time, providing additional funding relative to the base case.

The 2016-17 NWAU has been reduced due to safety and quality measures for the purposes of calculating the base for 2017-18 activity growth. The 2017-18 total has also reduced due to safety and quality measures.

Example: deterioriation in safety and quality				
	2016-17	2017-18	2018-19	2019-20
Price (NEP)	$5,000	$5,000	$5,000	$5,000
Back-casted NEP	$5,000	$5,000	$5,000	$5,000
Growth year NWAUs	1,000,000	1,060,000	1,121,000	1,180,000
PQS NWAU deduction		-11,000	-12,000	-13,000
PQS Adjusted NWAUs		1,049,000	1,109,000	1,167,000
Back-casted NWAUs pre-PQS adjustment	1,000,000	1,060,000	1,121,000	
PQS NWAU deduction	-10,000	-11,000	-12,000	
PQS adjusted NWAU Base for following year	990,000	1,049,000	1,109,000	
NWAU Growth		59,000	60,000	58,000
Uncapped Funding	$2,000,000,000	$2,132,750,000	$2,265,000,000	$2,395,500,000
Uncapped Funding Growth		6.64%	6.34%	5.76%
Cap Amount		$2,130,000,000	$2,268,450,000	$2,412,225,000
Cap Reduction		$2,750,000	$0	$0
Final Funding	$2,000,000,000	$2,130,000,000	$2,265,000,000	$2,395,500,000
Final Funding Growth		6.50%	6.34%	5.76%
		+0	**-2,250,000**	**-4,500,000**

In this example, safety and quality measures have deteriorated over time, providing less funding relative to the base case. The 2016-17 NWAU has been reduced due to safety and quality measures for the purposes of calculating the base for 2017-18 activity growth. The 2017-18 total has also reduced due to safety and quality measures.

Appendix B: Commonwealth NHR Funding Planning Tool

The Commonwealth NHR funding planning tool is designed to assist stakeholders in determining the growth in Commonwealth NHR funding for the relevant financial years. The tool is State based which limits the calculation of the redistribution amounts under the National Funding Cap which require inputs for all States.

The Administrator can provide informal estimates of the Commonwealth NHR funding to States where requested.

Appendix C: Relevant National Health Reform Agreement Clauses

National Health Reform Agreement (2011) *(including amendments under clause I5)*	
Implementation of the Agreement	
12	The Commonwealth and States will implement public hospital governance and financing arrangements as set out by this Agreement in line with the timeframes identified in this Agreement. In recognition of the implementation by the States of these reforms, the Commonwealth will provide growth funding between 2014-15 and 2019-20 through meeting 45 per cent of efficient growth.
Commonwealth Funding	
A3	From 1 July 2014, the Commonwealth will fund 45 per cent of efficient growth of activity based services, increasing to 50 per cent from 1 July 2017. Efficient growth consists of: a. the national efficient price for any changes in the volume of services provided (the role of the national efficient price and how it will be determined is set out in Schedule B); and b. the growth in the national efficient price of providing the existing volume of services.
A4	Where services or functions are more appropriately funded through block grants and for teaching, training and research, the Commonwealth will fund 45 per cent of growth in the efficient cost of providing the services or performing the functions from 1 July 2014, increasing to 50 per cent from 1 July 2017. The efficient cost will be determined annually by the IHPA, taking account of changes in utilisation, the scope of services provided and the cost of those services to ensure the Local Hospital Network has the appropriate capacity to deliver the relevant block funded services and functions.
Block funding	
A29	On the basis of this advice, the IHPA will determine which hospital services and functions are eligible for Commonwealth funding on a block grant basis.
A30	Using the IHPA's determination the Administrator of the National Health Funding Pool (the Administrator) will then calculate the Commonwealth's funding contribution for block funded services and functions.
Payments for Services Funded on an Activity Basis	
A34	In 2014-15, 2015-16 and 2016-17, the Commonwealth's funding for each ABF service category will be calculated individually for each State by summing: a. previous year amount: the Commonwealth's percentage funding rate for the relevant State in the previous year multiplied by the volume of weighted services provided in the previous year multiplied by the national efficient price in the previous year; b. price adjustment: the volume of weighted services provided in the previous year multiplied by the change in the national efficient price relative to the previous year multiplied by 45 per cent; and c. volume adjustment: the net change in volume of weighted services to be provided in the relevant State (relative to the volume of weighted services provided in the previous year) multiplied by the national efficient price multiplied by 45 per cent.
A35	The Commonwealth percentage funding rate for each ABF service category in each State will be calculated by dividing the sum of clause A34 by the relevant year's total volume of weighted services multiplied by the national efficient price.

A36	The Administrator will provide the Commonwealth and States with a formal forecast of the Commonwealth's funding contribution for each ABF service category before the start of each financial year. The formal forecast will be provided within 14 calendar days of receipt of both: a. service volume information for all Local Hospital Networks within a State, as provided in Service Agreements; and b. the forecast national efficient price from the IHPA.
A38	For 2017-18 and later years, the Commonwealth's funding for each ABF service category will be calculated as per clause A34 but replacing the 45 per cent rate specified in clauses A34(b) and A34(c) with 50 per cent.
A39	The methodologies set out in clauses A34, A35 and A38 relate to the calculation of preliminary payment entitlements. Final payment entitlements will be made after the reconciliation adjustments specified in clause B59-61 have been completed.
A40	If the IHPA makes any significant changes to the ABF classification systems or costing methodologies, the effect of such changes must be back-cast to the year prior to their implementation for the purpose of the calculations set out in clauses A34, A35 and A38. The IHPA will consider transitional arrangements when developing new ABF classification systems or costing methodologies.
A42	ABF will be implemented through a phased approach: a. the implementation of nationally consistent ABF approaches for acute admitted services, emergency department services and non-admitted patient services (initially using the Tier 2 outpatient clinics list) will commence on 1 July 2012; and b. the implementation of nationally consistent ABF approaches for any remaining non-admitted services, mental health and sub-acute services will commence on 1 July 2013.
Public Health Activities	
A43	Payments for public health activities for 2014-15 will be equal to the previous year's payment indexed by the former National Healthcare SPP growth factor.
A44	Unless otherwise agreed, beyond 2014-15 the Commonwealth's commitment to public health will continue to grow by the former National Healthcare SPP growth factor.
Teaching, Training and Research	
A47	Payments for 2014-15, 2015-16 and 2016-17 will consist of the previous year's payment plus 45 per cent of the growth in the efficient cost of providing the relevant function calculated in accordance with clause A4.
A48	Payments for 2017-18 and later years will consist of the previous year's payment plus 50 per cent of the growth in the efficient cost of providing the relevant function, calculated in accordance with clause A4.
A49	The IHPA will provide advice to the Standing Council on Health on the feasibility of transitioning funding for teaching, training and research to ABF or other appropriate arrangements reflecting the volumes of activities carried out under these functions by no later than 30 June 2018.
Block Funded Services	
A50	Payments for 2014-15, 2015-16 and 2016-17 will consist of the previous year's payment plus 45 per cent of the growth in the efficient cost of providing the services, adjusted for the addition or removal of block services as provided in clauses A27-A30 (calculated in accordance with clause A4).
A51	Payments for 2017-18 and later years will consist of the previous year's payment plus 50 per cent of the growth in the efficient cost of providing the services, adjusted for the addition or removal of block services as provided in clauses A27-A30 (calculated in accordance with clause A4).

Funding Flows	
A89	Commonwealth funding contributions will flow to the provider jurisdiction through the National Health Funding Pool. Steps will be taken to prevent Commonwealth payments made in accordance with these arrangements being subject to equalisation by the Commonwealth Grants Commission to avoid financially disadvantaging one State.
National Health Funding Pool	
B21	There will be complete transparency and line-of-sight of respective contributions into and out of Pool accounts to Local Hospital Networks, discrete State managed funds, or to State health departments in relation to public health funding and any top-up funding, and of the basis on which the contributions are calculated. There will also be complete transparency and line-of-sight of respective contributions out of State managed funds to Local Hospital Networks.
Governance	
B26	Commonwealth legislation will provide for the Administrator to perform the following functions: d. publicly reporting on: v. top-up payments made by the Commonwealth through the National Health Funding Pool to the States;
Payments into the National Health Funding Pool and State Managed Funds	
B46	Commonwealth payments into the pool will be made monthly, calculated as 1/12th of the estimated annual payment. Commonwealth payments will be made into the National Health Funding Pool in accordance with Schedule D of the IGA FFR.
Payments from the National Health Funding Pool and State Managed Funds	
B52	The payment arrangements for Commonwealth funding are as follows: d. public health funding and any top-up funding will flow through Pool accounts to State health departments.
Adjustments to the Commonwealth's Contribution to Local Hospital Networks Funding *(including amendments under clause I5)*	
B61	The annual adjustment will be conducted in arrears once actual volumes have been validated by the service volume Reconciliations to ensure the Commonwealth meets its agreed contribution to the funding of efficient growth.
B63	States will provide to the Administrator, within at least three months (with a preference to reducing the period over time) of the end of each reconciliation period, gross volume and patient identified data regarding actual services delivered for those public hospital functions funded by the Commonwealth on an activity basis to enable reconciliations to be undertaken in accordance with clause B60. Variations for the service volume reconciliation will include, but not be limited to, the reconciliation of general transcription errors, including the incorrect coding of services provided and duplicate entries, and the exclusion of services paid for by the Commonwealth via other funding streams, the exclusion of services for which data has not been provided, and the exclusion of services with incomplete data.
B75	States will provide the Administrator with a copy of the Service Agreement for each Local Hospital Network once agreed between the State and the Local Hospital Network.
Service Agreements	
D9	Service Agreements will be publicly released by States within fourteen calendar days of finalisation or amendment and will then also be made available through relevant national bodies. States may agree additional matters with Local Hospital Networks (such as the delivery of additional programs).

Addendum to the National Health Reform Agreement (2017)	
Public hospital funding arrangements	
I10	Growth in annual Commonwealth funding for national Public Hospital Services, will not exceed 6.5 per cent a year (the National Funding Cap) while this Part is operational. Details on the operation of the National Funding Cap are outlined below.
I11	Parties agree to improve the accuracy of NWAU estimates by allowing States to provide non-binding advice to the Commonwealth and the Administrator on expected services to be delivered, without the need to vary Service Agreements. The provision of this advice will not affect Commonwealth payments or cash flows to LHNs.
Activity Based Funding	
I14	The Parties reiterate their commitment to funding Public Hospital Services under ABF and confirm the ongoing operation of the arrangements and calculation processes contained in Schedule A of the Agreement, subject to modification in the Clauses below, including: a. the operation of the National Funding Cap and Soft Caps; b. the incorporation of a Data Conditional Payment to promote the prompt provision of the Required Data; and c. changes in the proportion of efficient growth met by Commonwealth contributions.
I15	From 1 July 2017 to 30 June 2020, the Commonwealth will fund 45 per cent of the efficient growth of ABF service delivery, subject to the operation of the National Funding Cap. References in the Agreement to a Commonwealth contribution of 50 per cent of efficient growth are not operational for the life of this Part.
Block funded services funding	
I18	The Commonwealth will continue to provide funding to States for Public Hospital Services or functions that are more appropriately funded through Block Funding in accordance with Schedule A and will fund 45 per cent of the growth in the efficient cost of providing these services or performing these functions. References in the Agreement to a Commonwealth contribution of 50 per cent of the growth in the efficient cost are not operational for the life of this Part. a. Commonwealth payments for block funded services for the life of this Part will continue to be calculated consistent with the process outlined in Schedule A of the Agreement, with the exception that the Commonwealth will fund 45 per cent of the growth in the efficient cost.
Public health activity funding	
I19	Commonwealth payments for public health activities for the life of this Part will continue to be calculated in accordance with Schedule A of the Agreement.
Funding cap	
I20	The Parties agree to give effect to a cap in overall growth in Commonwealth funding of 6.5 per cent a year (the National Funding Cap) for the period 2017 18 to 2019 20. In doing so, it is the intention of the Parties that: a. A Soft Cap will be applied to the Commonwealth Funding Entitlement of each State throughout the relevant financial year; b. Any funding remaining under the National Funding Cap will be subject to proportionate Redistribution as part of the annual Reconciliation under Clause I27; c. while the National Funding Cap applies to Commonwealth contributions to Public Hospital Services in aggregate, any adjustments to funding as a result of the National Funding Cap will be applied to the Commonwealth funding contribution for ABF Services only;

	d. should the growth in Commonwealth funding under this Agreement not exceed 6.5 per cent at a national level, each State will receive its Uncapped Commonwealth Funding Entitlement for that State; and e. no State will receive more than its Uncapped Commonwealth Funding Entitlement for Public Hospital Services delivered in a relevant financial year.
Role of the Administrator	
I21	The Administrator will apply the National Funding Cap and Soft Cap in calculating and delivering advice to the Commonwealth Treasurer in respect of the Commonwealth contribution to the National Health Funding Pool under the Agreement.
Determining preliminary Commonwealth funding	
I22	Prior to the commencement of a relevant financial year covered by this Part, the Administrator will calculate a State's estimated Commonwealth Funding Entitlement as the lower of: a. 106.5 per cent of the State's most recent estimated Commonwealth Funding Entitlement for the State for the previous financial year, excluding any adjustments relating to prior year activities; or b. That State's estimated Uncapped Commonwealth Funding Entitlement for the relevant financial year.
I23	Estimated Commonwealth Funding Entitlements can be updated during the course of the year as outlined in Clause B57 of the Agreement. Adjustments to payments remain subject to the Soft Cap.
I24	For the avoidance of doubt, a State will not receive any Commonwealth funding in excess of the Soft Cap until after annual reconciliation, at which time it may be entitled to payment of a Redistribution Amount.
Determining final Commonwealth funding	
I25	The Administrator will undertake annual Reconciliation for each State following the receipt of Required Data from all States. The Administrator will not finalise an annual Reconciliation for individual States that have provided the Required Data until all other States have provided Required Data.
I26	In undertaking the annual Reconciliation the Administrator will calculate any Sentinel Event or Safety and Quality Adjustment that applies to a State in a relevant financial year.
I27	Following the completion of the annual Reconciliation, the Administrator will calculate the final Commonwealth Funding Entitlements for a State for that year as follows: a. Where a State has an Uncapped Commonwealth Funding Entitlement less than or equal to the Soft Cap, then the State's Commonwealth Funding Entitlement will equal its Uncapped Commonwealth Funding Entitlement. b. Where a State has an Uncapped Commonwealth Funding Entitlement that is more than its Soft Cap and the sum of all of the States Uncapped Commonwealth Funding Entitlements is less than or equal to the National Funding Cap, then the State's Commonwealth Funding Entitlement will equal its Uncapped Commonwealth Funding Entitlement. c. Where a State has an Uncapped Commonwealth Funding Entitlement that is more than its Soft Cap, and the sum of all of the States Uncapped Commonwealth Funding Entitlements is more than the National Funding Cap, then the State's Commonwealth Funding Entitlement is its Soft Cap, plus a Redistribution Amount, calculated by the following formula:

	National funding available for redistribution X $\frac{\text{Individual State's funding shortfall}}{\text{National funding shortfall}}$ Where: The 'national funding available for redistribution' is the sum of the difference of each State's Uncapped Commonwealth Funding Entitlement and the Soft Cap where the State's Uncapped Commonwealth Funding Entitlement's is less than the Soft Cap. The 'individual State's funding shortfall' is the amount by which its Uncapped Commonwealth Funding Entitlement exceeds the Soft Cap. The 'national funding shortfall' is the sum of all the 'individual State's funding shortfall'.
Certainty of reconciliation	
I28	The Parties agree that the final Commonwealth Funding Entitlement of a State will not be adjusted unless a Party has notified the Administrator of an issue affecting its accuracy within 12 months of the end of the relevant financial year. The Administrator will not make any further adjustments to funding relating to that financial year, unless it is to resolve an issue raised within that 12 month period. a. This does not restrict the Administrator's ability to identify issues including inaccuracies or errors within 12 months of the end of the relevant financial year.
I29	A notice for the purpose of Clause I28 must be issued in writing by a senior officer of the relevant health department and provide full particulars of the nature and extent of the issue and the likely impact on the State's Commonwealth Funding Entitlement. A Statement of Assurance must accompany any further submission of data by a State to remedy an identified issue.
I30	If an issue is identified or raised with the Administrator, the Administrator will notify the Commonwealth and States of the issue and how the Administrator plans to resolve the issue.
I31	The Administrator will calculate the impact on the Commonwealth Funding Entitlement of each State, including any applicable Redistribution Amounts, following the assessment of the issue by the Administrator.
I32	The Administrator will assess and advise whether adjustments to the Commonwealth Funding Entitlement of the States should be made. Following resolution of the issue, the Administrator will notify the Commonwealth and States of the outcome.
Data Conditional Payment	
I35	The Parties agree to incorporate a Data Conditional Payment (DCP) to encourage the prompt provision of the Required Data in order to facilitate timely Reconciliation and payment of any Redistribution Amounts due to States. The DCP will be a variation to the timing of payments under Clause B46 of this Agreement.
I36	If a state has not provided the Required Data for annual Reconciliation within three months of the end of the Reconciliation period the Administrator will, in calculating the Commonwealth contribution to the National Health Funding Pool for that state, advise the Treasurer to defer payment of 10 per cent of the amount payable to the State in November of the current year, until the Required Data is provided.

I37	If a state has not provided the Required Data for the annual Reconciliation within four months of the end of the Reconciliation period, the Administrator will, in calculating the Commonwealth contribution to the National Health Funding Pool for that state, advise the Treasurer to defer a further 15 per cent of the amount payable to the States in December of the current year, until the Required Data is provided.
Incorporating quality and safety intro hospital pricing and funding	
I60	The Parties agree to develop reforms to integrate safety and quality into the pricing and funding of Public Hospital Services in a way that: a. Improves patient outcomes; b. Provides an incentive in the system to provide the right care, in the right place, at the right time; c. Decreases avoidable demand for public hospital services; and d. Signals to the health system the need to reduce instances of preventable poor quality patient care, while supporting improvements in data quality and information available to inform clinicians' practice.
I62	For the avoidance of doubt, the Parties agree that Sentinel Events and Safety and Quality adjustments will be subject to back-casting under Clause A40.
Sentinel events	
I63	The Parties agree that any episode of care that gives rise to a Sentinel Event will not be funded by the Commonwealth from 1 July 2017. The episode will be assigned a NWAU of zero.
I64	States agree to apply a digital flag as soon as practicable to any episode that includes a Sentinel Event and report this information to IHPA as part of data submissions under Clauses A8 and B93 of this Agreement. The Parties will consider development of a linkable dataset as a longer-term solution by 30 June 2020.
Hospital Acquired Complications	
I65	The Parties agree to develop, in consultation with the ACSQHC, IHPA and the Administrator, a comprehensive pricing and funding model, that: a. Is rigorous, fair and transparent; b. Does not incentivise under reporting, or adversely affect service delivery; and c. Is significant enough to be an effective overall price signal from the Commonwealth through to hospitals.
I66	The Parties agree to shadow the preferred pricing and funding option for HACs from 1 July 2017 in order to: a. Improve data quality and identify any significant issues that need to be addressed prior to implementation; b. Monitor any changes in the incidence of HACs in public hospitals; c. Refine data and reporting requirements for HACs occurring in public hospitals; d. Engage with the health system to ensure readiness for the implementation of the agreed model; e. Confirm the suitability of complications on the HAC List for inclusion in a pricing and funding model; f. Engage broadly with clinician groups on the proposed approach to ensure efficacy; and g. Refine the HAC risk and complexity adjustment methodology in consultation with the Commonwealth and States in 2017, including a peer review process to ensure that it is fit for purpose.

I67	IHPA will develop a preliminary report assessing the shadow implementation, including the impact of the preferred model on funding, data reporting, clinical information systems, and specific population and peer hospital groups. The preliminary report will be publicly consulted on, with the final report to be submitted to COAG Health Council by 30 November 2017. a. To assess shadow implementation, IHPA will use available activity data and the most recent available cost data from the National Hospital Cost Data Collection.
I68	The Parties intend to introduce a pricing and funding model for HACs from 1 July 2018, subject to the results of the shadow implementation to be considered by COAG Health Council.
I69	To confirm the suitability of the complications on the HAC List in a pricing and funding model, the Parties will use the following four criteria: a. Preventability: i. Clinical evidence is available to demonstrate that the HAC can be prevented with 'best clinical practice'. ii. Evidence supports that individual LHNs (including single campus and specialist hospitals) are able to prevent the HAC and that the causes of such condition are within the control of the hospital. iii. The strength of external influences (e.g. patient factors) does not unduly impact the LHN's ability to avoid the HAC. iv. There is sufficient evidence to inform / instruct health services on how to avoid the HAC. i. The development of the HAC measure has been subjected to valid construction. The inferences used to test the HAC have been made on the basis of appropriate measurements and occurrences can be easily defined, identified and adequately measured. b. Impact: i. The introduction of the financial adjustments related to specific HAC will result in a significant enough change to funding at the hospital level to drive the intended clinical practice outcome, impact appropriately on patients and improve patient outcomes. ii. Unintended consequences as a result of practice or reporting changes are not likely to be to the detriment of individual and hospital-wide patient care. iii. The rate of HAC by LHN (giving consideration to size and type of hospital) is sufficient to warrant introduction of a financial mechanism. c. Feasibility: i. Reporting mechanisms are sufficiently robust to ensure that any benefit obtained through under reporting is minimised. ii. Sufficient information is available to other bodies, such as the National Health Funding Body, to monitor the impact of the financial mechanism on the prevalence of the HAC across the system. iii. Sufficient processes, systems, policies, feedback mechanisms and data collections are in place to support the reduction of the HAC across each LHN. iv. The introduction of the HAC is prioritised to obtain maximum benefit. d. Equity: i. The application of pricing and funding adjustment does not unfairly impact any one, or group, of providers as a result of characteristics beyond their control (e.g. size, location and type of hospital).

Avoidable Hospital Readmissions	
I74	The Parties agree to determine an appropriate model for Avoidable Hospital Readmissions for implementation not before 1 July 2018, taking into account advice to COAG Health Council.
I77	Adjustments to Commonwealth funding for an individual State resulting from Sentinel Events, HACs and Avoidable Hospital Readmissions will be incorporated in the calculation and determination of the State's Commonwealth Funding Entitlement. The Commonwealth Funding Entitlement for a given year, incorporating these adjustments, will form the base for the calculation of the State's soft cap in the following year.
I78	Any downward adjustment to an individual State for Sentinel Events, HACs and Avoidable Hospital Readmissions will not be deducted from the total available pool of Commonwealth funding under the National Funding Cap and will be available for Redistribution.
Roles and responsibilities	
I86	The Administrator will: a. calculate Commonwealth Funding Entitlement of States with reported Sentinel Events, from 1 July 2017; b. calculate Safety and Quality Adjustments to be made using the pricing and funding models nominated for this purpose by the Parties, from 1 July 2018 or such later date as the Parties nominate; and c. advise the Commonwealth Treasurer of a) and b) during annual Reconciliation and a) during six monthly Reconciliation.

Appendix D: Glossary

In this document, unless otherwise specified, words and phrases are to be interpreted as follows:

(the) Act	The Commonwealth *National Health Reform Act 2011*
Activity Based Funding (ABF)	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 Hospital Pricing Authority. Funding is based on the actual number of services provided to patients and the efficient cost of delivering those services.
(the) Addendum	The Addendum to the National Health Reform Agreement entered into by all states, territories and the Commonwealth in 2017, included as Schedule I to the Agreement. The Addendum sets out additional reforms to the way in which public hospitals are funded nationally.
(the) Administrator	The Administrator of the National Health Funding Pool (the Administrator) is an independent statutory office holder, distinct from Commonwealth and State government departments, established under legislation of the Commonwealth and State governments. The role of the Administrator, with support from the National Health Funding Body, is to administer the payment of public hospital funding according to the Agreement, and to oversee payments into and out of the Reserve Bank state pool account for each State, collectively known as the National Health Funding Pool (the funding pool).
(the) Agreement	See ‘National Health Reform Agreement’
Australian Commission on Safety and Quality in Health Care (ACSQHC)	A corporate Commonwealth entity established under Commonwealth legislation to lead and coordinate national improvements in safety and quality in health care.
Avoidable Hospital Readmission	A clinical condition identified by the Australian Commission on Safety and Quality in Health Care for the purpose of Clause I71.

back-casting	If the Independent Hospital Pricing Authority makes any significant changes to the Activity Based Funding classification systems or costing methodologies, the effect of such changes must be back-cast to the year prior to their implementation. Independent Hospital Pricing Authority will consider transitional arrangements when developing new Activity Based Funding classification systems or costing methodologies.
base amount	Refers to the funding amount that is calculated prior to the Reconciliation adjustment is applied.
base year	Relates to the year before the relevant financial year.
block funding	A system of funding public hospital functions and services as a fixed amount based on population and previous funding. Under the Agreement, funding is provided to support: • Public hospital functions other than patient services; and • Public patient services provided by facilities that are not appropriately funded through Activity Based Funding. Public hospital functions other than patient services includes teaching and research undertaken in public hospitals. Block funding is used in place of Activity Based Funding for some public hospital services where it is more appropriate, particularly smaller rural and regional hospitals.
Calculated National Health Reform funding	Relates to the sum of the calculated Public Health, Block and Activity Based Funding under the Agreement, which is aggregated to assess whether the Funding Cap is exceeded.
Commonwealth Funding Entitlement	In respect of a State, its Uncapped Commonwealth Funding Entitlement, adjusted for the imposition of the Soft Cap and any Redistribution Amount that may be payable. It may be expressed on an estimated basis prior to annual Reconciliation or a final basis after annual Reconciliation and Redistribution.

cross-border	When a resident of one state receives hospital treatment in another state, the 'resident state' compensates the treating or 'provider state' for the cost of that care via a cross-border payment. Commonwealth activity-based funding contributions through the National Health Funding Pool to each State are on a 'provider state' basis and hence already reflect the Commonwealth share of the costs of this cross-border activity. For State activity-based funding contributions, the 'resident state' is required to meet the state portion of the cost of services where its resident receives hospital treatment in another state or territory. The resident state makes cross-border funding contributions to the provider state's pool account, and these funds are used by the provider state as part of its activity-based funding payments to Local Hospital Networks. Cross-border agreements, including the scope of services and payment arrangements, can occur bilaterally between all states.
Data Conditional Payment	The mechanism described in Clause I35 of the Agreement to provide an incentive for the prompt provision of hospital activity data to enable timely Reconciliation. A temporary adjustment to Commonwealth National Health Reform funding resulting from late submission of the required data for annual Reconciliation.
efficient growth	Efficient growth is the growth in funding related to the change in the national efficient price (price adjustment) and the change in the volume of services delivered (volume adjustment) for a given financial year.
ex-ante adjustment	*Ex-ante* adjustments are those which occur prior or during the funding period (i.e. the relevant financial year).
ex-post adjustment	*Ex-post* are those adjustments that occur once the period has concluded (i.e. adjustments relating to prior financial years).
Federal Financial Relations Act 2009 (FFR Act)	The *Federal Financial Relations Act 2009* provides a standing appropriation for the Commonwealth to make ongoing financial contributions to the States through four National Special Purpose Payments and National Health Reform funding.
funding pool	See 'National Health Funding Pool'.

Hospital Acquired Complication (HAC)	A condition set out on the Hospital Acquired Complication List, maintained by the Australian Commission on Safety and Quality in Health Care and approved by the COAG Health Council.
Independent Hospital Pricing Authority (IHPA)	An independent statutory body established under Commonwealth legislation to calculate and deliver an annual national efficient price used in the calculation of national Activity Based Funding for Australian public hospitals.
Intergovernmental Agreement on Federal Financial Relations	The Intergovernmental Agreement on Federal Financial Relations details arrangements for the funding and delivery of government services.
Local Hospital Network (LHN)	Recipients of the payments from the National Health Funding Pool, Commonwealth block funding and state managed funds. An organisation that provides public hospital services in accordance with the Agreement. A Local Hospital Network can contain one or more hospitals, and is usually defined as a business group, geographical area or community. Every Australian public hospital is part of a Local Hospital Network. Some States use other terminology to describe Local Hospital Networks, such as ‘local health districts’.
Mid-year Economic and Fiscal Outlook (MYEFO)	The MYEFO updates the economic and fiscal outlook from the previous budget. As well as updating the economic and fiscal outlook, the MYEFO updates the budgetary position. In particular, the MYEFO takes account of all decisions made since the release of the budget which affect expenses and revenue and hence revises the budget aggregates.
National Efficient Cost (NEC)	The Independent Hospital Pricing Authority determines a national efficient cost for services that are not suitable for Activity Based Funding, such as small rural hospitals. The national efficient cost determines the Commonwealth contribution to block funded hospitals. Hospitals are assigned to a size-locality grouping and mean expenditure is calculated for groupings. The Independent Hospital Pricing Authority removes the out-of-scope costs and indexes model costs to reflect efficient costs for the year of the national efficient cost.

National Efficient Price (NEP)	The base price determined by the Independent Hospital Pricing Authority and applied to those services funded on the basis of activity for the purpose of determining the amount of Commonwealth funding to be provided to Local Hospital Networks. The national efficient price is based on the projected average cost of a National Weighted Activity Unit after the deduction of specified Commonwealth funded programs.
National Funding Cap	The limit in growth in Commonwealth funding for Public Hospital Services for all States of 6.5 per cent per annum and where the context so requires includes the operation of the Funding Cap as provided in this Agreement. Calculated as the base year national Commonwealth funding multiplied by 106.5 per cent, inclusive of any Safety and Quality Adjustments and Funding Cap adjustments.
National Health Funding Body (NHFB)	An independent statutory body established under Commonwealth legislation to assist the Administrator in carrying out his or her functions under Commonwealth, State legislation.
National Health Funding Pool (NHFP)	The combined State Pool Accounts for each State and Territory. The National Health Funding Pool was established under Commonwealth and State legislation for the purpose of receiving all Commonwealth and activity based State public hospital funding, and for making payments under the Agreement.
National Health Reform (NHR)	National health reform included reforms to the way in which public hospitals are funded nationally in Australia, as set out in the National Health Reform Agreement entered into by all states, territories and the Commonwealth in August 2011.
National Health Reform Agreement	The National Health Reform Agreement outlines the funding, governance, and performance arrangements for the delivery of public hospital services in Australia. The Agreement was entered into by all states, territories and the Commonwealth in August 2011.
National Health Reform (NHR) funding	Replaces the National Healthcare Special Purpose Payment under the Intergovernmental Agreement on Federal Financial Relations from 1 July 2012. This amount is divided into Activity Based Funding, block funding, and public health funding.
National Healthcare Special Purpose Payment (SPP)	Special purpose payments from the Commonwealth to States specifically for the funding of public hospitals.

National Weighted Activity Unit (NWAU)	The National Weighted Activity Unit (NWAU) is a measure of health service activity expressed as a common unit, against which the national efficient price is paid. It provides a way of comparing and valuing each public hospital service (whether it is an admission, emergency department presentation or outpatient episode), by weighting it for clinical complexity. The 'average' hospital service is worth one NWAU – the most intensive and expensive activities are worth multiple NWAUs, the simplest and least expensive are worth fractions of an NWAU. The NWAU will be updated annually, and will be named to reflect the year of its operation. This means that in 2014-15, the NWAU will be called NWAU (14), and so on.
prior year	Relates to the year before the base year.
prior year adjustment	Prior year adjustments occur when the Administrator adjusts the funding in respect of services delivered in the prior year (see definition above) after the Treasurer's Determination has been made, to correct for issues identified in the prior year.
Public Health funding	Public Health funding covers amounts previously relating to national public health, youth health services and essential vaccines (service delivery) in 2008-09 ($244.0 million).
Reconciliation	The Reconciliation of actual Activity Based Funding service delivery volume undertaken within a State to the estimate of Activity Based Funding service delivery volumes provided by a State in accordance with Clauses B59 to B64.
Reconciliation Adjustment	The adjustment made to the Commonwealth contributions to Local Hospital Networks (in arrears), based on the actual volume of services provided by Local Hospital Networks.
Redistribution	The allocation of remaining funding under the National Funding Cap to States whose Uncapped Commonwealth Funding Entitlement exceeded their respective Soft Funding Cap in accordance with Clause I27.
Redistribution Amount	An amount paid by the Commonwealth to a State that is entitled to additional funds as a result of the Redistribution.
relevant financial year	A specific financial year for which data is submitted by the Parties so that the Administrator can calculate the Commonwealth funding and payments for that financial year.

Safety and Quality Adjustment	A reduction in funding payable to a State by the Commonwealth for Public Hospital Services, funded either under Activity Based or Block Funding, following the occurrence of a Hospital Acquired Complication or an Avoidable Hospital Readmission in accordance with the pricing and funding models to be developed by the Parties for this purpose.
Sentinel Event	An event set out on the Sentinel Events List, maintained by the Australian Commission on Safety and Quality in Health Care and approved by the COAG Health Council.
Service Agreement	An agreement between a State or other bodies to provide agreed services, for example between a State and a Local Hospital Network in accordance with the Agreement.
Soft Cap	The limit in growth in Commonwealth funding for Public Hospital Services in a State of 6.5 per cent per annum. Calculated as 106.5 per cent of the State's most recent estimated Commonwealth Funding Entitlement for the State for the previous financial year, excluding any adjustments relating to prior year activities. The Soft Cap determines at an aggregate State level the maximum Commonwealth National Health Reform funding payable based on estimated activity.
State Managed Fund	A separate bank account or fund(s) established by a State for the purpose of receiving funding for block grants, teaching, training and research in accordance with the Agreement.
Statement of Assurance	The statement as to the completeness and accuracy of data submitted, issued in accordance with Clauses I40 and I41.
State Pool Account	A Reserve Bank account established by a State for the purpose of receiving all Commonwealth and activity-based State public hospital funding, and for making payments under the Agreement. The state pool accounts of all States are collectively known as the National Health Funding Pool.
Uncapped Commonwealth Funding Entitlement	In respect of a State in a relevant financial year, its entitlement to Commonwealth funding for Public Hospital Services in that State under the Agreement, excluding the impact of the National Funding Cap or any relevant Soft Cap.

Appendix E: Abbreviations and Acronyms

Abbreviation or Acronym	Meaning
ABF	Activity Based Funding
ACSQHC	Australian Commission on Safety and Quality in Health Care
CCM	Commonwealth Contribution Model
CCR	Commonwealth Contribution Rate
COAG	Council of Australian Governments
HAC	Hospital Acquired Complication
IHPA	Independent Hospital Pricing Authority
LHN	Local Hospital Network
MYEFO	Mid-Year Economic and Fiscal Outlook
NEC	National Efficient Cost
NEP	National Efficient Price
NHFB	National Health Funding Body
NHFP	National Health Funding Pool
NHR	National Health Reform
NWAU	National Weighted Activity Unit
SPP	Special Purpose Payment