

PPS rate year, and 3.0 percent for proposed 2008 LTCH PPS rate year. We also have taken into account our Office of the Actuary's projection that there would be an increase in Medicare beneficiary enrollment of 1.3 percent in proposed 2004 LTCH PPS rate year, 1.6 percent in proposed 2005 LTCH PPS rate year, and 1.9 percent in proposed 2006 LTCH PPS rate year and 2.0 percent in proposed 2007 LTCH PPS rate year and 2.1 percent in proposed 2008 LTCH PPS rate year.

Because the LTCH PPS was only recently implemented, sufficient new data have not been generated that would enable us to conduct a comprehensive reevaluation of our budget neutrality calculations. Therefore, we are not proposing an adjustment for budget neutrality under § 412.523(d)(3) at this time. However, we will continue to collect and interpret new data as the data become available in the future to determine if such an adjustment should be proposed.

#### VII. Computing the Proposed Adjusted Federal Prospective Payments

In accordance with § 412.525 and as discussed in sections VI. of this

proposed rule, the proposed standard Federal rate would be adjusted to account for differences in area wages by multiplying the labor-related share of the proposed standard Federal rate by the appropriate proposed LTCH wage index. The proposed standard Federal rate would also be adjusted to account for the higher costs of hospitals in Alaska and Hawaii by multiplying the nonlabor-related share of the proposed standard Federal rate by the appropriate adjustment factor shown in the table in section VI.C.2. of this preamble. To illustrate the methodology we are using to adjust the proposed Federal prospective payments, we are providing the following example:

During the proposed 2004 LTCH PPS rate year, a Medicare patient is in a LTCH located in Chicago, Illinois (MSA 1600) with a proposed two-fifths wage index value of 1.0418 (see Table 1 in the Addendum to this proposed rule). The Medicare patient is classified into LTC-DRG 4 (Spinal Procedures), which has a proposed relative weight of 1.2493 (see Table 3 of the Addendum to this proposed rule). To calculate the LTCH's total adjusted Federal prospective

payment for this Medicare patient, we compute the wage-adjusted Federal prospective payment amount by multiplying the unadjusted proposed standard Federal rate (\$35,830.05) by the labor-related share (72.612 percent) and the proposed wage index (1.0418). This wage-adjusted amount is then added to the nonlabor-related portion of the unadjusted proposed standard Federal rate (27.388 percent) to determine the adjusted proposed Federal rate, which is then multiplied by the proposed LTC-DRG relative weight (1.2493) to calculate the total adjusted proposed Federal prospective payment for the proposed 2004 LTCH PPS rate year (\$46,121.11). In addition, as discussed in section VI.C.6. of this preamble, for the proposed 2004 LTCH PPS rate year, we are proposing to reduce the LTCH PPS payment by 5.6 percent for the proposed budget neutrality offset to account for the costs of the transition methodology. The following illustrates the components of the calculations in this example:

Proposed Unadjusted Standard Federal Prospective Payment Rate .....	\$35,830.05
Labor-Related Share .....	0.72612
Labor-Related Portion of the Federal Rate .....	= \$26,016.92
Proposed %th Wage Index (MSA 1600) .....	1.0418
Wage-Adjusted Labor Share .....	= \$27,104.43
Nonlabor-Related Portion of the Federal Rate (adjusted for COLA if applicable) .....	+ \$9,813.36
Adjusted Proposed Federal Rate .....	= \$36,917.56
Proposed LTC-DRG 4 Relative Weight .....	× 1.2493
Total Adjusted Proposed Federal Prospective Payment (Before the Proposed Budget Neutrality Offset) .....	= \$46,121.11
Proposed Budget Neutrality Offset .....	× 0.944
Total Proposed Federal Prospective Payment (With the Proposed Budget Neutrality Offset) .....	= \$43,538.33

#### VIII. Transition Period

To provide a stable fiscal base for LTCHs, under § 412.533, we implemented a 5-year transition period from reasonable cost-based reimbursement under the TEFRA system to a prospective payment based on industry-wide average operating and capital-related costs. Under the average pricing system, payment is not based on the experience of an individual hospital. We believe that a 5-year phase-in will provide LTCHs time to adjust their operations and capital financing to the new LTCH PPS, which is based on prospectively determined Federal

payment rates. Furthermore, we believe that the 5-year phase-in of the LTCH PPS allows LTCH personnel to develop proficiency with the LTC-DRG coding system, resulting in improvement in the quality of the data used for generating our annual determination of relative weights and payment rates.

In accordance with § 412.533, the transition period for all hospitals subject to the LTCH PPS begins with the hospital's first cost reporting period beginning on or after October 1, 2002 and extends through the hospital's last cost reporting period beginning before October 1, 2007. During the 5-year transition period, a LTCH's total

payment under the LTCH PPS is based on two payment percentages—one based on reasonable cost-based (TEFRA) payments and the other based on the standard Federal prospective payment rate. The percentage of payment based on the LTCH PPS Federal rate increases by 20 percentage points each year, while the TEFRA rate percentage decreases by 20 percentage points each year, for the next 4 fiscal years. For cost reporting periods beginning on or after October 1, 2006, Medicare payment to LTCHs will be determined entirely under the Federal PPS methodology. The blend percentages are as follows:

Cost reporting periods beginning on or after	Federal rate percentage	Reasonable cost principles rate percentage
October 1, 2002 .....	20	80
October 1, 2003 .....	40	60
October 1, 2004 .....	60	40