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### I. Background

#### A. Requirements for Updating the Prospective Payment Rates for Inpatient Rehabilitation Facilities (IRFs)

On August 7, 2001, we published a final rule entitled “Medicare Program; Prospective Payment System for Inpatient Rehabilitation Facilities (CMS-1069-F)” in the **Federal Register** (66 FR 41316), that established a PPS for IRFs as authorized under section 1886(j) of the Act and codified at subpart P of part 412 of the Medicare regulations. In the August 7, 2001 final rule, we set forth per discharge Federal prospective payment rates for fiscal year (FY) 2002 that provided payment for inpatient operating and capital costs of furnishing covered rehabilitation services (that is, routine, ancillary, and capital costs) but not costs of approved educational activities, bad debts, and other services or items that are outside the scope of the IRF PPS. The provisions of that final rule were effective for cost reporting periods beginning on or after January 1, 2002. (On July 1, 2002, we also published a correcting amendment to the final rule (CMS-1069-F2) in the **Federal Register** (67 FR 44073). Any reference to the August 7, 2001 final

rule in this proposed rule includes the provisions effective in the correcting amendment.)

Section 1886(j)(5) of the Act and § 412.628 of the regulations require the Secretary to publish in the **Federal Register**, on or before August 1 of the preceding fiscal year, the classifications and weighting factors for the IRF case-mix groups (CMGs) and a description of the methodology and data used in computing the prospective payment rates for the upcoming fiscal year. On August 1, 2002, we published a notice in the **Federal Register** (67 FR 49928) to update the IRF Federal prospective payment rates from FY 2002 to FY 2003 using the methodology described in § 412.624 of the regulations. As stated in that notice, we used the same classifications and weighting factors for the IRF CMGs that were set forth in the August 7, 2001 final rule to update the IRF Federal prospective payment rates from FY 2002 to FY 2003. The FY 2003 Federal prospective payment rates are effective for discharges on or after October 1, 2002 and before October 1, 2003.

In this proposed rule, we are proposing to update the IRF Federal prospective payment rates from FY 2003 to FY 2004 using the methodology described in § 412.624 of the regulations. See section VI of this proposed rule for further discussion of the proposed FY 2004 Federal prospective payment rates. The proposed FY 2004 Federal prospective payment rates will be effective for discharges on or after October 1, 2003 and before October 1, 2004.

#### B. General Overview of the Current IRF PPS

Section 4421 of the Balanced Budget Act of 1997 (BBA) (Pub. L. 105–33), as amended by section 125 of the Medicare, Medicaid, and SCHIP Balanced Budget Refinement Act of 1999 (BBRA) (Pub. L. 106–113), and by section 305 of the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) (Pub. L. 106–554), provides for the implementation of a per discharge PPS, through new section 1886(j) of the Act, for inpatient rehabilitation hospitals and inpatient rehabilitation units of a hospital (IRFs). Payments under the IRF PPS encompass inpatient operating and capital costs of furnishing covered rehabilitation services (that is, routine, ancillary, and capital costs) but not costs of approved educational activities, bad debts, and other services or items outside the scope of the IRF PPS. Although a complete discussion of the IRF PPS provisions appears in the

August 7, 2001 final rule (66 FR 41316), we provide below a general description of the IRF PPS.

The IRF PPS, as described in the August 7, 2001 final rule, uses Federal prospective payment rates across 100 distinct CMGs. Ninety-five CMGs were constructed using rehabilitation impairment categories, functional status (both motor and cognitive), and age (in some cases, cognitive status and age may not be a factor in defining a CMG). Five special CMGs were constructed to account for very short stays and for patients who expire in the IRF.

For each of the CMGs, we developed relative weighting factors to account for a patient's clinical characteristics and expected resource needs. Thus, the weighting factors account for the relative difference in resource use across all CMGs. Within each CMG, the weighting factors were “tiered” based on the estimated effect that the existence of certain comorbidities have on resource use.

The Federal PPS rates were established using a standardized payment amount (also referred to as the budget neutral conversion factor in the August 7, 2001 final rule (66 FR 41364 through 41367)). For each of the tiers within a CMG, the relative weighting factors were applied to the budget neutral conversion factor to compute the unadjusted Federal prospective payment rates. Adjustments that account for geographic variations in wages (wage index), the percentage of low-income patients (LIPs), and location in a rural area would be applied to the IRF's unadjusted Federal prospective payment rates. In addition, adjustments would be made to account for the early transfer of a patient, interrupted stays, and high cost outliers.

Lastly, the IRF's final prospective payment amount would be determined under the transition methodology prescribed in section 1886(j) of the Act. Specifically, for cost reporting periods that began on or after January 1, 2002 and before October 1, 2002, section 1886(j)(1) of the Act and § 412.626 of the regulations provide that IRFs transition into the prospective payment systems receiving a “blended payment.” For cost reporting periods that began on or after January 1, 2002 and before October 1, 2002, these blended payments consisted of 66⅔ percent of the Federal IRF PPS rate and 33⅓ percent of the payment that the IRF would have been paid had the IRF PPS not been implemented. However, during the transition period, an IRF with a cost reporting period beginning on or after January 1, 2002 and before October 1, 2002 could have elected to bypass this blended payment