

reclassifications approved by the MGCRB or the Administrator as of February 28, 2003, and the effects of section 1886(d)(10)(D)(v) of the Act to extend wage index reclassifications for 3 years. The effects of any additional reclassification changes that occur as a result of appeals and reviews of the MGCRB decisions for FY 2004 or from a hospital's request for the withdrawal of a reclassification for FY 2004 will be reflected in the final budget neutrality adjustment required under section 1886(d)(8)(D) of the Act and published in the IPPS final rule for FY 2004.

c. **Outliers.** Section 1886(d)(5)(A) of the Act provides for payments in addition to the basic prospective payments, for "outlier" cases, that is, cases involving extraordinarily high costs. To qualify for outlier payments, a case must have costs above a fixed-loss cost threshold amount (a dollar amount by which the costs of a case must exceed payments in order to qualify for outlier payment). To determine whether the costs of a case exceed the fixed-loss threshold, a hospital's cost-to-charge ratio is applied to the total covered charges for the case to convert the charges to costs. Payments for eligible cases are then made based on a marginal cost factor, which is a percentage of the costs above the threshold.

Under section 1886(d)(5)(A)(iv) of the Act, outlier payments for any year must be projected to be not less than 5 percent nor more than 6 percent of total operating DRG payments plus outlier payments. Section 1886(d)(3)(B) of the Act requires the Secretary to reduce the average standardized amounts by a factor to account for the estimated proportion of total DRG payments made to outlier cases. Similarly, section 1886(d)(9)(B)(iv) of the Act requires the Secretary to reduce the average standardized amounts applicable to hospitals in Puerto Rico to account for the estimated proportion of total DRG payments made to outlier cases.

i. **FY 2004 outlier fixed-loss cost threshold.** In the August 1, 2002 IPPS final rule (67 FR 50124), we established a threshold for FY 2003 that was equal to the prospective payment rate for the DRG, plus any IME and DSH payments and any additional payments for new technology, plus \$33,560. The marginal cost factor (the percent of costs paid after costs for the case exceed the threshold) was 80 percent.

In the March 5, 2003 **Federal Register** (67 FR 10420), we published proposed changes to our outlier policy. We noted recent analyses indicate that some hospitals have taken advantage of our existing outlier payment methodology to maximize their

outlier payments. Therefore, we proposed three central changes to our outlier policy in the March 5, 2003 proposed rule.

The first of the proposed changes was that fiscal intermediaries would use more up-to-date data when determining the cost-to-charge ratio for each hospital. Currently, fiscal intermediaries use the hospital's most recent settled cost report. We proposed to revise our regulations to specify that fiscal intermediaries would use either the most recent settled or the most recent tentative settled cost report, whichever is from the latest reporting period.

The second proposed change was to remove the current requirement in our regulations specifying that a fiscal intermediary will assign a hospital the statewide average cost-to-charge ratio when the hospital has a cost-to-charge ratio that falls below established thresholds (3 standard deviations below the national geometric mean cost-to-charge ratio). We proposed that hospitals would receive their actual cost-to-charge ratios no matter how low their ratios actually fall.

The third proposal was to add a provision to our regulations to provide that the outlier payments for some hospitals may become subject to reconciliation when the hospitals' cost reports are settled. In addition, outlier payments would be subject to an adjustment to account for the time value of any outlier overpayments or underpayments that are ultimately reconciled.

However, as of the time this FY 2004 proposed rule was prepared, these proposed changes to the outlier policy had not been finalized. Therefore, the proposed changes have not been factored into the calculation of the proposed FY 2004 fixed-loss threshold. If these changes are made final prior to (or as part of) the publication of the final FY 2004 fixed-loss threshold, they will be reflected in the analysis used to establish the final FY 2004 threshold.

To calculate the proposed FY 2004 outlier thresholds, we simulated payments by applying proposed FY 2004 rates and policies using cases from the FY 2002 MedPAR file. Therefore, in order to determine the appropriate proposed FY 2003 threshold, it was necessary to inflate the charges on the MedPAR claims by 2 years, from FY 2002 to FY 2004.

As discussed in the August 1, 2002 IPPS final rule (67 FR 50124), rather than use the rate-of-cost increase from hospitals' FY 1998 and FY 1999 cost reports to project the rate of increase from FY 2001 to FY 2003, as had been done in prior years, we used a 2-year average annual rate of change in charges per

case to calculate the FY 2003 outlier threshold.

We are proposing to continue to use a 2-year average annual rate of change in charges per case to establish the proposed FY 2004 threshold. The 2-year average annual rate of change in charges per case from FY 2000 to FY 2001, and from FY 2001 to FY 2002, was 12.8083 percent annually, or 27.3 percent over 2 years.

Using the methodology above for setting the charge inflation factors for FY 2004, we are proposing to establish a fixed-loss cost outlier threshold equal to the prospective payment rate for the DRG, plus any IME and DSH payments, and any add-on payments for new technology, plus \$50,645.

This single threshold would be applicable to qualify for both operating and capital outlier payments. We also are proposing to maintain the marginal cost factor for cost outliers at 80 percent.

Again, any final rule subsequent to the March 5, 2003 proposed rule that implements changes to the outlier payment methodology is likely to affect how we will calculate the final FY 2004 outlier threshold. Therefore, the final FY 2004 threshold is likely to be different from this proposed threshold, as a result of any changes subsequent to the March 5, 2003 proposed rule. For example, if we were to implement the proposal to no longer apply the statewide average cost-to-charge ratio when hospitals' actual ratios fall below the established threshold (see below), this change would impact our calculation of the threshold.

ii. **Other changes concerning outliers.** As stated in the September 1, 1993 final rule (58 FR 46348), we establish outlier thresholds that are applicable to both hospital inpatient operating costs and hospital inpatient capital-related costs. When we modeled the combined operating and capital outlier payments, we found that using a common set of thresholds resulted in a higher percentage of outlier payments for capital-related costs than for operating costs. We project that the proposed thresholds for FY 2004 would result in outlier payments equal to 5.1 percent of operating DRG payments and 5.5 percent of capital payments based on the Federal rate.

In accordance with section 1886(d)(3)(B), we reduced the proposed FY 2004 standardized amounts by the same percentage to account for the projected proportion of payments paid to outliers. The proposed outlier adjustment factors to be applied to the standardized amounts for FY 2004 are as follows:

	Operating standardized amounts	Capital federal rate
National	0.948981	0.945484
Puerto Rico	0.981549	0.984490

We apply the outlier adjustment factors after removing the effects of the FY 2003 outlier adjustment factors on the standardized amounts.

To determine whether a case qualifies for outlier payments, we apply hospital-specific cost-to-charge ratios to the total covered charges for the case. Operating and capital costs for the case are calculated separately by

applying separate operating and capital cost-to-charge ratios. These costs are then combined and compared with the fixed-loss outlier threshold.