

Once again, although a final rule subsequent to the March 5, 2003 proposed rule on outliers may be published before (or as part of) the FY 2004 IPPS final rule, we are proposing changes for FY 2004 without taking the proposals contained in the March 5, 2003 proposed rule into account at this time.

For those hospitals for which the fiscal intermediary computes operating cost-to-charge ratios lower than 0.194 or greater than 1.223, or capital cost-to-charge ratios lower than 0.012 or greater than 0.163, we are proposing statewide average ratios would be used to calculate costs to determine whether a hospital qualifies for outlier payments.⁷ Table 8A in section VI. of this Addendum contains the proposed statewide average operating cost-to-charge ratios for urban hospitals and for rural hospitals for which the fiscal intermediary is unable to compute a hospital-specific cost-to-charge ratio within the above range. These proposed statewide average ratios would replace the ratios published in the August 1, 2002 IPPS final rule (67 FR 50263). Table 8B in section VI. of this Addendum contains the proposed comparable statewide average capital cost-to-charge ratios. Again, the cost-to-charge ratios in Tables 8A and 8B would be used during FY 2004 when hospital-specific cost-to-charge ratios based on the latest settled cost report are either not available or are outside the range noted above.

iii. FY 2002 and FY 2003 outlier payments. In the August 1, 2002 IPPS final rule (67 FR 50125), we stated that, based on available data, we estimated that actual FY 2002 outlier payments would be approximately 6.9 percent of actual total DRG payments. This estimate was computed based on simulations using the FY 2001 MedPAR file (discharge data for FY 2001 bills). That is, the estimate of actual outlier payments did not reflect actual FY 2002 bills but instead reflected the application of FY 2002 rates and policies to available FY 2001 bills.

Our current estimate, using available FY 2002 bills, is that actual outlier payments for FY 2002 were approximately 7.9 percent of actual total DRG payments. Thus, the data indicate that, for FY 2002, the percentage of actual outlier payments relative to actual total payments is higher than we projected before FY 2002 (and thus exceeds the percentage by which we reduced the standardized amounts for FY 2002). Nevertheless, consistent with the policy and statutory interpretation we have maintained since the inception of the IPPS, we do not plan to make retroactive adjustments to outlier payments to ensure that total outlier payments for FY 2002 are equal to 5.1 percent of total DRG payments.

We currently estimate that actual outlier payments for FY 2003 will be approximately 5.5 percent of actual total DRG payments, 0.4 percentage points higher than the 5.1 percent we projected in setting outlier policies for FY

2003. This estimate is based on simulations using the FY 2002 MedPAR file (discharge data for FY 2002 bills). We used these data to calculate an estimate of the actual outlier percentage for FY 2003 by applying FY 2003 rates and policies including an outlier threshold of \$33,560 to available FY 2002 bills. If changes to the outlier payment methodology are made effective during FY 2003, these may affect the actual percentage of FY 2003 outlier payments.

5. FY 2004 Standardized Amounts

The adjusted standardized amounts are divided into labor and nonlabor portions. Table 1A in section VI. of this Addendum contains the two national standardized amounts that we are proposing will be applicable to all hospitals, except hospitals in Puerto Rico. As described in section II.A.1. of this Addendum, we are not proposing to revise the labor share of the national standardized amount from 71.1 percent.

The following table illustrates the proposed changes from the FY 2003 national average standardized amounts. The first row in the table shows the updated (through FY 2003) average standardized amounts after restoring the FY 2003 offsets for outlier payments and geographic reclassification budget neutrality. The DRG reclassification and recalibration and wage index budget neutrality factor is cumulative. Therefore, the FY 2003 factor is not removed from the amounts in the table.

	Large urban	Other Areas
FY 2003 Base Rate (after removing reclassification budget neutrality and outlier offset)	Labor \$3,212.32	Labor \$3,161.41
Proposed FY 2004 Update Factor	Nonlabor 1,276.01	Nonlabor 1,285.01
Proposed FY 2004 DRG Recalibrations and Wage Index Budget Neutrality Factor	1.035	1.035
Proposed FY 2004 Reclassification Budget Neutrality Factor	1.003133	1.003133
Proposed FY 2004 Outlier Factor	0.991848	0.991848
Proposed Rate for FY 2004 (after multiplying FY 2003 base rate by above factors)	0.948997	0.948997
	Labor \$3,139.26	Labor \$3,089.56
	Nonlabor 1,276.01	Nonlabor 1,255.81

Under section 1886(d)(9)(A)(ii) of the Act, the Federal portion of the Puerto Rico payment rate is based on the discharge-weighted average of the national large urban standardized amount and the national other standardized amount (as set forth in Table 1A). The labor and nonlabor portions of the national average standardized amounts for Puerto Rico hospitals are set forth in Table 1C of section VI. of this Addendum. This table also includes the Puerto Rico standardized amounts. The labor share applied to the Puerto Rico standardized amount is 71.3 percent.

B. Adjustments for Area Wage Levels and Cost-of-Living

Tables 1A and 1C, as set forth in section VI. of this Addendum, contain the labor-related and nonlabor-related shares that we are proposing to use to calculate the prospective payment rates for hospitals located in the 50 States, the District of Columbia, and Puerto Rico. This section

addresses two types of adjustments to the standardized amounts that are made in determining the proposed prospective payment rates as described in this Addendum.

1. Adjustment for Area Wage Levels

Sections 1886(d)(3)(E) and 1886(d)(9)(C)(iv) of the Act require that we make an adjustment to the labor-related portion of the national and Puerto Rico prospective payment rates, respectively, to account for area differences in hospital wage levels. This adjustment is made by multiplying the labor-related portion of the adjusted standardized amounts by the appropriate wage index for the area in which the hospital is located. In section III. of this preamble, we discuss the data and methodology for the proposed FY 2004 wage index. The proposed FY 2004 wage index is set forth in Tables 4A, 4B, 4C, and 4F of section VI. of this Addendum.

2. Adjustment for Cost-of-Living in Alaska and Hawaii

Section 1886(d)(5)(H) of the Act authorizes an adjustment to take into account the unique circumstances of hospitals in Alaska and Hawaii. Higher labor-related costs for these two States are taken into account in the adjustment for area wages described above. For FY 2004, we are proposing to adjust the payments for hospitals in Alaska and Hawaii by multiplying the nonlabor portion of the standardized amounts by the appropriate adjustment factor contained in the table below. If the Office of Personnel Management releases revised cost-of-living adjustment factors before July 1, 2003, we will publish them in the final rule and use them in determining FY 2004 payments.

⁷ This range represents 3.0 standard deviations (plus or minus) from the mean of the log distribution of cost-to-charge ratios for all hospitals.