

the March 7, 2003, proposed rule. We also discuss the factors used to establish the final update to the LTCH PPS standard Federal rate for the 2004 LTCH PPS rate year in this final rule, which will be effective for LTCHs paid under the LTCH PPS for discharges occurring on or after July 1, 2003, through June 30, 2004. In the final rule published on August 30, 2002 (67 FR 56029–56031), for cost reporting periods beginning on or after October 1, 2002 (FY 2003), we computed the LTCH PPS standard Federal payment rate by updating the best available (FY 1998 or FY 1999) Medicare inpatient operating and capital costs per case data, using the excluded hospital market basket.

Section 123(a)(1) of Public Law 106–113 requires that the PPS developed for LTCHs be budget neutral. Therefore, in calculating the standard Federal rate for FY 2003 under § 412.523(d)(2), we set total estimated PPS payments equal to estimated payments that would have been made under the reasonable cost-based payment methodology had the PPS for LTCHs not been implemented. Section 307(a) of Public Law 106–554 specified that the increases to the hospital-specific target amounts and cap on the target amounts for LTCHs for FY 2002 provided for by section 307(a)(1) of Public Law 106–554 shall not be taken into account in the development and implementation of the LTCH PPS. In addition, the statute as amended by section 122 of Public Law 106–113 provides for enhanced bonus payments for LTCHs for two years, FY 2001 and FY 2002. Furthermore, as specified at § 412.523(d)(1), the standard Federal rate is reduced by an adjustment factor to account for the estimated proportion of outlier payments under the LTCH PPS to total LTCH PPS payments (8 percent). For further details on the development of the FY 2003 standard Federal rate, *see* the August 30, 2002, final rule (67 FR 56027–56037). Under the existing regulations at § 412.523(c)(3)(ii) for fiscal years after FY 2003, we update the standard Federal rate annually to adjust for the most recent estimate of the projected increases in prices for LTCH inpatient hospital services.

B. Update to the Standard Federal Rate for the 2004 LTCH PPS Rate Year

In the August 30, 2002, final rule (67 FR 56033), we established a LTCH PPS standard Federal rate of \$34,956.15 for FY 2003. As discussed in the March 7, 2003, proposed rule (68 FR 11248), based on the most recent estimate of the excluded hospital with capital market basket, adjusted to account for the change in the rate year update cycle for

the LTCH PPS rates, we proposed that the LTCH PPS standard Federal rate, effective from July 1, 2003, through June 30, 2004, would be \$35,726.64. Based on updated data, including the most recent estimate of the excluded hospital with capital market basket adjusted to account for the change in the rate year update cycle for the LTCH PPS rates, and the policies described in this final rule, the LTCH PPS standard Federal rate, effective from July 1, 2003, through June 30, 2004, is \$35,726.18 (as discussed below).

In the discussion that follows, we explain how we developed the update to the final standard Federal rate for the 2004 LTCH PPS rate year in this final rule. The final standard Federal rate for the 2004 LTCH PPS rate year is calculated based on the final update factor of 1.0220. Thus, we estimate that the final standard Federal rate for the 2004 LTCH PPS rate year will increase 2.2 percent compared to the FY 2003 standard Federal rate.

1. Standard Federal Rate Update

In the August 30, 2002, final rule, we established at § 412.523 that, for years after FY 2003, the annual update to the LTCH PPS standard Federal rate will be equal to the percentage change in the excluded hospital with capital market basket (described in further detail below). As we discussed in the August 30, 2002, final rule (67 FR 56087), in the future we may propose to develop a framework to update payments to LTCHs that would account for other appropriate factors that affect the efficient delivery of services and care provided to Medicare patients. As we stated in the March 7, 2003, proposed rule (68 FR 11244), because the LTCH PPS has only recently been implemented (for cost reporting periods beginning on or after October 1, 2002), we have not yet collected sufficient data to allow for the analysis and development of an update framework under the LTCH PPS. Therefore, in that same proposed rule, we did not propose an update framework for the 2004 LTCH PPS rate year. However, we noted that a conceptual basis for the proposal of developing an update framework in the future can be found in Appendix B of the August 30, 2002, final rule (67 FR 56086–56090).

a. Description of the Market Basket for LTCHs for the 2004 LTCH PPS Rate Year

A market basket has historically been used in the Medicare program to account for price increases of the services furnished by providers. The market basket used for the LTCH PPS

includes both operating and capital-related costs of LTCHs because the LTCH PPS uses a single payment rate for both operating and capital-related costs. The development of the LTCH PPS standard Federal rate is discussed in further detail in the August 30, 2002 final rule (67 FR 56027–56037).

Under the reasonable cost-based payment system, the excluded hospital market basket was used to update the hospital-specific limits on payment for operating costs of LTCHs. The excluded hospital market basket is based on operating costs from FY 1992 cost report data and includes data from Medicare-participating long-term care, rehabilitation, psychiatric, cancer, and children's hospitals. Since LTCHs' costs are included in the excluded hospital market basket, this market basket index, in part, also reflects the costs of LTCHs. However, in order to capture the total costs (operating and capital-related) of LTCHs, we added a capital component to the excluded hospital market basket for use under the LTCH PPS. We refer to this index as the excluded hospital with capital market basket.

As we discussed in both the August 30, 2002, final rule (67 FR 56016 and 56086–56086) and the March 7, 2003, proposed rule (68 FR 11245–11247), beginning with the implementation of the LTCH PPS in FY 2003, the excluded hospital with capital market basket based on FY 1992 Medicare cost report data has been used for updating payments to LTCHs. The FY 1992-based market basket reflected the distribution of costs in FY 1992 for Medicare-participating freestanding rehabilitation, long-term care, psychiatric, cancer, and children's hospitals. This information was derived from the FY 1992 Medicare cost reports. A full discussion of the methodology and data sources used to construct the FY 1992-based excluded hospital with capital market basket is included in Appendix A of the August 30, 2001, final rule (67 FR 56085–56086). In the March 7, 2003, proposed rule, we proposed to revise and rebase the excluded hospital with capital market basket, using more recent data, that is, using FY 1997 base year data beginning with the proposed 2004 LTCH PPS rate year.

As we stated in the March 7, 2003, proposed rule (68 FR 11245–11247), we believe it was appropriate to propose to revise and rebase the LTCH PPS market basket based on the most recent complete data available (FY 1997) because these data would more accurately reflect LTCHs' current costs. Furthermore, we noted that this proposed revising and rebasing of the LTCH PPS market basket from an FY