

actual cost-to-charge ratio. At the end of the fiscal year, the hospital would receive a new cost-to-charge ratio based on its 3-year rolling average when in reality its actual cost-to-charge ratio is much lower. A hospital could continue to stay ahead of the system every year and receive outlier payments that do not reflect its actual cost-to-charge ratio. This is the exact behavior we are trying to prevent and, therefore, we believe we need to implement the process of reconciliation to dissuade hospitals from gaming the system.

Comment: Other commenters believed reconciliation would lead to further unpredictability and volatility in the Medicare payment system and would have implications for cost report simplification. Another commenter expressed similar concerns that some hospitals' cost reports may not be settled for longer than 2 to 3 years and would be subject to large overpayments that would then be subject to an adjustment for the time value of money. Similarly, a hospital's cost report can be reopened at a later date even after final settlement, which would cause further uncertainty if reconciliation had been conducted in the past.

Response: We plan to issue further guidance through program memoranda detailing the specific operational aspects of reconciling outlier payments on the cost report. At this time, we are still developing the specific procedures involved, including the exact timing of any reconciliation in terms of the cost reporting settlement process and the appeals process.

Comment: Several commenters argued that it would be inappropriate, illogical, and inconsistent with current policies to single-out outliers for adjustments to account for the time value of money. The commenters pointed out that other IPPS payment adjustments, such as IME and DSH, are subject to reconciliation but hospitals are not charged for the time value of money when those overpayments or underpayments are reconciled. However, another commenter agreed that outlier payments are substantially different from IME and DSH payments and the premise for adjusting for the time value of money with respect to outlier payments (when it is limited to situations where the cost-to-charge ratio is substantially inaccurate, and does not involve policy disputes) is not applicable to other adjustments such as IME and DSH.

Response: As we noted above and in the proposed rule, outlier payments are uniquely susceptible to manipulation because hospitals set their own level of charges and are able to change their charges without notification to, or

review by, their fiscal intermediary. Such changes by a hospital directly affect its level of outlier payments, unlike IME or DSH where the fiscal intermediary must agree to a change to the underlying data. Therefore, even though the money may be recouped if the outlier payments are reconciled, the hospital would essentially be able to unilaterally increase its charges and acquire an interest-free loan in the meantime. For that reason, we believe it is appropriate to apply an adjustment for the time value of overpayments or underpayments identified at cost report reconciliation. Because the other changes we are making in this final rule will largely ensure the payments hospitals receive for outlier cases are accurate, we do not anticipate it will be necessary to apply this adjustment broadly. Therefore, the actual total impact of this adjustment should be relatively small.

Comment: One commenter argued that there is no statutory authorization for this adjustment. The commenter referenced section 1815(d) of the Act (42 U.S.C. 1395g(d)), which provides that interest is charged when a final determination is made and payment is not made within 30 days of the date of the determination. The commenter concluded there is no authority to impose interest in any fashion except in a manner consistent with this statutory authorization, and, thus, the proposed time value adjustment should be withdrawn.

Response: The reference cited by the commenter authorizes Medicare to charge and pay interest when an overpayment or underpayment is made. However, the referenced statutory authority is not the basis for the proposal to adjust outlier payments for the time value of money when reconciliation is made. Rather, this adjustment is consistent with the statutory requirement at section 1886(d)(5)(A)(iii) that outlier payments approximate the marginal cost of care beyond the threshold. That is, because hospitals are uniquely able to manipulate outlier payments by increasing charges, it is necessary to establish a mechanism whereby an adjustment can be made to ensure payments appropriately reflect the true marginal costs of care for outlier cases. As a result, the outlier adjustment can be distinguished from other IPPS payment adjustments where interest is applied, such as IME or DSH, because changes to these adjustments are subject to review by the fiscal intermediary before additional payments are made.

C. Provisions of the Final Rule Relating to Reconciliation of Outlier Payments Through Settled Cost Reports

We are adding § 412.84(i)(3) to provide that, effective 60 calendar days after the date of publication of this final rule, outlier payments will become subject to adjustment when hospitals' cost reports coinciding with the discharge are settled.

Payments will be processed throughout the year using the appropriate historical operating and capital cost-to-charge ratios, consistent with the regulations. When the cost report is settled, any reconciliation of outlier payments by fiscal intermediaries will be based on operating and capital cost-to-charge ratios calculated based on a ratio of costs to charges computed from the cost report and charge data determined at the time the cost report coinciding with the discharge is settled. We intend to issue program instructions to the fiscal intermediaries that will provide specific criteria for identifying those hospitals subject to reconciliation for the remainder of FY 2003 and for FY 2004. These criteria for FY 2003 will allow the fiscal intermediaries to focus their limited resources on only those hospitals that appear to have disproportionately benefited from the time lag in updating their cost-to-charge ratios. The criteria for FY 2004 will target a somewhat broader group of hospitals, but will still be limited to those hospitals that have benefited the most from the time lag in updating cost-to-charge ratios, and the majority of hospitals will not be affected. Also, fiscal intermediaries will have the administrative discretion to reconcile additional hospitals' cost reports based on analysis that indicates the outlier payments made to those hospitals are significantly inaccurate.

In addition, effective for discharges occurring on or after 60 calendar days after the date of publication of this final rule, for those hospitals for which reconciliation is necessary, outlier payments will be adjusted to account for the time value of any underpayments or overpayments (§ 412.84(m)).

VI. Fixed-Loss Outlier Threshold for IPPS Hospitals

A. Background and Provisions of the March 5, 2003 Proposed Rule

As noted above, 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 estimated operating DRG payments plus outlier payments. Section 1886(d)(3)(B) of the