

rule through an adjustment to the fiscal year 1999 update to the SNF PPS rates.

As noted in the May 12, 1998 interim final rule, the existing update framework for the inpatient hospital capital PPS already includes an adjustment to account for forecast error (see the regulations at § 412.308(c)(1)(ii)). The update framework for the inpatient hospital operating PPS includes a similar forecast error adjustment as well. However, the latter framework serves as the basis for making a recommendation to the Congress, which then establishes the actual update amount for the operating PPS through legislation. In the context of discussing a possible update framework for the SNF PPS in the FY 2002 proposed rule published on May 10, 2001 (66 FR 24018 through 24019), we observed that in this existing update framework,

a forecast error adjustment has typically been included, to reflect that the updates are set prospectively and some degree of forecast error is inevitable. In the case of the inpatient hospital PPS, this adjustment is made on a two-year lag and only if the error exceeds a defined threshold (0.25 percentage points).

Further, in the FY 2002 final rule published on July 31, 2001 (66 FR 39586), one commenter specifically suggested establishing a mechanism in the SNF PPS to account for forecast error. In response, we noted that the development of a SNF-specific update framework “* * * would give us the ability to factor in a forecast error adjustment in our recommendation for an update to SNF payments.”

As the preceding discussion indicates, our consideration of adopting a mechanism for making forecast error adjustments has, to date, occurred exclusively within the broader context of developing a SNF-specific update framework, where the end result would be solely a recommendation to the Congress, rather than an actual adjustment to the payment rates. However, it might also be possible to establish a forecast error adjustment mechanism independently as a separate initiative, as we discuss in the following sections of this proposed rule.

II. Proposed Adjustment to the Annual Increase in the SNF Market Basket Index Amount to Account for Forecast Error

A. Background

Since the implementation of the SNF PPS in July 1998, annual updates to the national PPS rate have been based on the forecasted percent change in the SNF market basket for the upcoming fiscal year. The SNF market basket was

described in detail in the interim final rule that we published on May 12, 1998 (63 FR 26289), and in the final rule published on July 31, 2001 (65 FR 39581). The use of a forecasted market basket percent change is consistent with section 1888(e)(5) of the Act, which directs us to establish a market basket index for SNFs that “* * * reflects changes over time in the prices of an appropriate mix of goods and services” included in covered SNF services, and to calculate the percentage change in that index from the midpoint of the prior fiscal year to the midpoint of the current one. It is also consistent with the methodology used for other prospective payment systems, most notably the inpatient hospital PPS.

The forecast of the SNF market basket percent change for the upcoming fiscal year is based on data that are available when the final rule is developed. This generally means that historical data that are available through the first quarter of the current calendar year are used to develop forecasts for the upcoming fiscal year. For example, the SNF market basket percent change for the FY 2003 payment update was forecast in June 2002, with historical data available through the first quarter of 2002. We purchase the forecasts of the individual price series in the SNF market basket from a leading macroeconomic forecasting firm, Global Insights, Inc. We define the SNF market basket forecast error as the difference in the forecasted percent change in the SNF market basket and the actual percent change in the SNF market basket for a given period, generally the fiscal year.

Upon further consideration of the language of the statute and consistent with the use of a forecast to calculate the market basket percentage under section 1888(e)(5) of the Act, we believe that the statute provides us with authority to make adjustments to the update to the SNF per diem amount computed under section 1888(e)(4)(E)(ii)(IV) of the Act to adjust for differences in the forecasted percent change in the SNF market basket and the actual percent change in the SNF market basket, determined on the basis of later acquired, actual data. Pursuant to section 1888(e)(4)(E)(ii)(IV) of the Act, the SNF market basket percentage calculated by the Secretary is used to update the per diem rate computed for the prior fiscal year in order to determine the unadjusted Federal per diem rates to be applied during the upcoming fiscal year. Consistent with section 1888(e)(4)(H)(i) of the Act, before August 1, the Secretary shall publish in the **Federal Register** “the unadjusted Federal per diem rates to be

applied to days of covered skilled nursing facility services furnished during the fiscal year.” There is, however, no requirement that this published figure be used for purposes of computing the payment rate for the following fiscal year. Rather, the annual update to the SNF per diem rate is equal to “the rate computed for the previous fiscal year increased by the skilled nursing facility market basket percentage change for the fiscal year involved” (section 1888(e)(4)(E)(ii)(IV) of the Act). Accordingly, we believe the language of these provisions supports an interpretation of the Act in which the payment rate for a fiscal year can be computed again after the end of a fiscal year to reflect later acquired, actual data regarding changes in the market basket, and that this recomputed rate could then be used in determining updates to the SNF payment rate for the subsequent fiscal year. Because the payment rates to be applied during a fiscal year are the rates that are published in the **Federal Register** by the August 1 preceding the start of the fiscal year, (see section 1888(e)(4)(H)(i) of the Act), any such adjustments would be made for FY 2004 and subsequent years.

B. Possible Approaches

We believe that establishing an adjustment for forecast error in prior years could help to further ensure that the payment rates appropriately reflect changes over time in the price of goods and services. However, it is important to consider certain additional factors in evaluating the feasibility of such an approach. In order to ensure that any such adjustment reflects actual market conditions accurately, it is absolutely essential that the adjustment be applied uniformly—not only in those instances where the forecasted percent change is lower than the actual percent change (as has been the case up to this point under the SNF PPS), but also in those instances where the forecasted percent change is higher than the actual percent change.

We note that the latter circumstance would result in SNFs receiving lower than expected payments. In fact, it is even possible that, under a certain set of circumstances (for example, a year in which the law specifies an adjustment of the SNF market basket percentage change minus one percentage point, in combination with a negative forecast error correction and low price inflation), it could actually yield a net *decrease* in payment rates.

This possibility underscores a potential disadvantage of establishing a forecast error adjustment, in that it would inevitably introduce an element