

of uncertainty regarding the amount of future updates. This uncertainty, in turn, would tend to detract from the prospective nature of the SNF payment system. In fact, the final rule that we published on January 3, 1984 at the inception of the prospective payment system for inpatient hospital services (49 FR 252) cited those very concerns in declining to adopt a suggestion to establish a forecast error adjustment at that point:

One of the purposes of the prospective payment system is that hospitals will know in advance of each discharge the amount of Medicare payment. Using the latest available market basket projections prior to the beginning of a particular Federal fiscal year is consistent with this concept. To permit retroactive adjustments of the market basket inflation rates would erode the prospective nature of the system. We believe this would introduce an element of uncertainty incompatible with the very purpose of the prospective payment system. Therefore, we have not adopted the suggestion that the rates be adjusted if market basket projections prove to be inaccurate.

Thus, while there are considerations that argue in favor of establishing an adjustment to account for forecast error, we believe that such a change also raises a number of concerns. Accordingly, we seek comments on the advisability of pursuing this approach.

Further, along with the basic question of whether to adopt a forecast error adjustment, it is also necessary to consider other related issues involving the precise nature of any such adjustment. For example, as further discussed in section II.D of this proposed rule, we are considering the inclusion of a threshold under which no forecast error adjustment would be made if the forecasted percent change is within 0.25 percentage points of the actual percent change (as is currently the case under the inpatient capital PPS). However, it would also be possible to set a different threshold, such as the 0.3 percentage point level that was used in updating the SNF routine cost limits under the reasonable cost payment methodology that preceded the SNF PPS. Alternatively, we could even use a significantly higher threshold in this context, such as a full percentage point.

In addition, we are considering that the initial forecast error adjustment would occur in FY 2004, and would take into account the cumulative forecast error between FYs 2000 and 2002, that is, since the beginning of the SNF PPS. We would apply the forecast error threshold of 0.25 percentage points to the forecast error calculation for the entire cumulative forecast error for FYs

2000 through 2002 instead of applying it to each year individually. We would do this because, in this calculation, the base payment rate is being adjusted in FY 2004 to bring the payment system in line with the actual experience. Alternatively, we could adopt an approach under which the initial adjustment takes into account only the forecast error for periods beginning after the effective date of the FY 2004 final rule. Under this alternative approach, the initial adjustment would not occur until FY 2006, and would take into account the forecast error from FY 2004. Accordingly, we invite comments not only on whether to adopt an adjustment to account for forecast error, but also on the specific characteristics of any such adjustment. The following describes the methodology that would be used if we considered an initial, cumulative forecast error adjustment provision.

#### *C. SNF Market Basket Forecast Error for FYs 2000 Through 2002*

The initial SNF market basket forecasted update under the SNF PPS was for FY 2000 (3.1 percent), followed by forecasted updates for FY 2001 (3.161 percent), FY 2002 (3.3 percent), and FY 2003 (3.1 percent). Historical market basket data are now available through FY 2002; therefore, we can calculate the cumulative SNF market basket forecast error for FYs 2000 through 2002, as shown in Table A. Historical data for the FY 2003 SNF market basket increase will not be available until early in 2004.

**TABLE A.—CUMULATIVE SNF MARKET BASKET FORECAST ERROR FOR FYs 2000 THROUGH 2002**

	Forecasted SNF market basket percent change	Actual SNF market basket percent change
FY 2000 .....	3.1	4.1
FY 2001 .....	3.161	5.1
FY 2002 .....	3.3	3.4
Cumulative Growth FY 2000 through 2002 .....	9.869	13.129
Cumulative SNF Market Basket Forecast Error ...	.....	3.26

**Note:** The FY 2000 and FY 2001 SNF market basket percent changes are based on the 1992-based SNF market basket. The FY 2002 SNF market basket percent changes are based on the 1997-based SNF market basket.

As indicated in Table A, the cumulative SNF market basket forecast error from FYs 2000 through 2002 is 3.26 percent. This figure is calculated by

taking the difference in the cumulative forecasted SNF market basket increase over this period ( $1.031 \times 1.03161 \times 1.033 = 1.09869$ ) and the cumulative actual SNF market basket increase ( $1.041 \times 1.051 \times 1.034 = 1.13129$ ). As mentioned previously in section II.B of this proposed rule, we applied the forecast error threshold of 0.25 percentage points to the forecast error calculation for the entire cumulative forecast error for FYs 2000 through 2002 instead of applying it to each year individually. We did this because, in this calculation, the base payment rate is being adjusted in FY 2004 to bring the payment system in line with the actual experience. The difference between these two cumulative increases equals 0.0326 (1.13129 minus 1.09869). This means that the SNF market basket was under-forecast by 3.26 percent for the period FY 2000 through 2002. Similarly, the base payment rate computed for FY 2003 was 3.26 percent lower than it would have been if actual data had been used.

The major reason that the SNF market basket forecast was under-forecast during this period was that wages and benefits for nursing home workers increased more rapidly than expected. This faster-than-expected increase occurred primarily because the health sector continued to grow rapidly despite the economic downturn, and also because of the impacts of nursing staff shortages and other conditions generally affecting the health care market.

In order to illustrate the potential impact that an initial, cumulative forecast error adjustment provision would have on payment rates, we are reproducing the original figures from Tables 1 and 2 in the FY 2004 SNF PPS proposed rule that appeared in the **Federal Register** on May 16, 2003 (68 FR 26761). The Federal rates in that proposed rule reflect an update to the rates that we published in the July 31, 2002 **Federal Register** (67 FR 49798) equal to the full change in the SNF market basket index. According to our interpretation of section 1888(e)(4)(E)(ii)(IV) of the Act, we would update the SNF PPS national base payment rate for FY 2003 by the cumulative forecast error amount. Thus, we would increase the SNF PPS national base payment rate for FY 2003 by 3.26 percent. We would then update the rate by adjusting the revised rate by the full SNF market basket index (see the May 16, 2003 proposed rule (68 FR 26775) for an explanation of how we calculate the full SNF market basket index). The FY 2004 market basket increase factor is 2.9 percent. We are inviting comments on including an