

there will always be a struggle to pay for it. The commenter noted that there needs to be a determination of what care will be paid for, and then hospitals need to decide if they will provide the noncovered services.

Another commenter believed that the final rule on outliers would affect hospitals that have applied outlier payments appropriately. The commenter also believed that Medicare beneficiaries would be impacted as community hospitals shift care to more costly tertiary care facilities due to concerns about underpayment for potentially complex patient cases. The commenter explained that it is concerned that claims processing errors in the application of the outlier provision may result in underreporting of services provided, which will perpetuate underpayments to hospitals and lead to long-term ramifications on the integrity of the data generated by the IPPS.

*Response:* As discussed above, we lowered the outlier threshold in response to the new provisions on outliers. We anticipate that, as a result of the changes implemented by our June 5, 2003 final rule, outlier payments will be better targeted to truly high-cost cases. This will help alleviate the commenters' concerns.

ii. Other changes concerning outliers. As stated in the September 1, 1993 final rule (58 FR 46348), we establish outlier thresholds that are applicable to both hospital inpatient operating costs and hospital inpatient capital-related costs. When we modeled the combined operating and capital outlier payments, we found that using a common set of thresholds resulted in a higher percentage of outlier payments for capital-related costs than for operating costs. We project that the thresholds for FY 2004 will result in outlier payments equal to 5.1 percent of operating DRG payments and 4.8 percent of capital payments based on the Federal rate.

In accordance with section 1886(d)(3)(B), we reduced the FY 2004 standardized amounts by the same percentage to account for the projected proportion of payments paid to outliers. The outlier adjustment factors to be applied to the standardized amounts for FY 2004 are as follows:

	Operating standardized amounts	Capital federal rate
National .....	0.949236	0.952050
Puerto Rico .....	0.976658	0.993231

We apply the outlier adjustment factors after removing the effects of the FY 2003 outlier adjustment factors on the standardized amounts.

To determine whether a case qualifies for outlier payments, we apply hospital-specific cost-to-charge ratios to the total covered charges for the case. Operating and capital costs for the case are calculated separately by applying separate operating and capital cost-to-charge ratios. These costs are then combined and compared with the fixed-loss outlier threshold.

The June 9, 2003 final rule eliminated the application of the statewide average for hospitals whose cost-to-charge ratios fall below 3 standard deviations from the national mean cost-to-charge ratio. However, for those hospitals for which the fiscal intermediary computes operating cost-to-charge ratios greater than 1.203 or capital cost-to-charge ratios greater than 0.163, or hospitals for whom the fiscal intermediary is unable to calculate a cost-to-charge ratio (as described at § 412.84(i)(3)), we are still using statewide average ratios to calculate costs to determine whether a hospital qualifies for outlier payments.<sup>8</sup> Table 8A in section VI. of this Addendum contains the 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 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 comparable statewide average capital cost-to-charge ratios. Again, the cost-to-charge ratios in Tables 8A and 8B will 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 7.8 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 6.5 percent of actual total DRG payments, 1.4 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. This estimate does not reflect the outlier policy changes implemented in the June 9, 2003 final rule that will become effective on August 8, 2003. Due to the limited time remaining in FY 2003 during which these changes will be effective, we do not anticipate that these changes will substantially affect our estimate.

#### 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 will be applying to all hospitals, except hospitals in Puerto Rico. As described in section II.A.1. of this Addendum, we are not revising the labor share of the national standardized amount from 71.1 percent.

The following table illustrates the 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: \$3,213.66 .....	Labor: \$2,974.75
	Nonlabor: \$1,306.26 .....	Nonlabor: \$1,209.15
FY 2004 Update Factor .....	1.034 .....	1.034
FY 2004 DRG Recalibrations and Wage Index Budget Neutrality Factor .....	1.005522 .....	1.005522
FY 2004 Reclassification Budget Neutrality Factor .....	0.992026 .....	0.992026
Adjusted for Blend of FY 2003 DRG Recalibration and Wage Index Budget Neutrality Factors (factor of 0.993209 effective October 1, 2002; factor of 0.993012 effective April 1, 2003).	Labor: \$3,314.31 .....	Labor: \$3,261.83
	Nonlabor: \$1,347.17 .....	Nonlabor: \$1,325.84
FY 2004 Outlier Factor .....	0.949236 .....	0.949236

<sup>8</sup> These figures represent 3.0 standard deviations from the mean of the log distribution of cost-to-charge ratios for all hospitals.