

“standard payment conversion factor.” We believe that the standard payment conversion factor better describes the standardized payment amount especially in those fiscal years where a budget neutrality adjustment is not made.

Under § 412.624(c)(3)(i), the standard payment conversion factor for FY 2002 of \$11,838.00 reflected the budget neutrality adjustment described in § 412.624(d)(2). Under the then existing § 412.624(c)(3)(ii), we updated the FY 2002 standard payment conversion factor (\$11,838.00) to FY 2003 by applying an increase factor (the IRF market basket index) of 3.0 percent, as described in the update notice published in the August 1, 2002 **Federal Register** (67 FR 49931). This yielded the FY 2003 standard payment conversion factor of \$12,193.00 that was published in the August 1, 2002 update notice (67 FR 49931). The FY 2003 standard payment conversion factor is the basis of the updated FY 2004 standard payment conversion factor that also reflects the adjustments described below.

### *C. Adjustments To Determine the FY 2004 Standard Payment Conversion Factor*

#### 1. IRF Market Basket Index

Section 1886(j)(3)(C) of the Act requires the Secretary to establish an increase factor that reflects changes over time in the prices of an appropriate mix of goods and services included in IRF services paid for under the IRF PPS, which is referred to as the IRF market basket index. Accordingly, in updating the FY 2004 payment rates set forth in this final rule, we will apply an appropriate increase factor, that is equal to the IRF market basket, to the FY 2003 IRF standardized payment amount.

Beginning with the implementation of the IRF PPS in FY 2002 and with the FY 2003 IRF PPS update, the 1992-based excluded hospital with capital market basket has been used to determine the IRF market basket factor for updating payments to rehabilitation facilities. The 1992-based market basket reflected the distribution of costs in 1992 for Medicare-participating freestanding rehabilitation, long-term care, psychiatric, cancer, and children's hospitals. This information was derived from the 1992 Medicare cost reports. A full discussion of the methodology and data sources used to construct the 1992-based excluded hospital with capital

market basket is available in Appendix D of the IRF PPS final rule published in the August 7, 2001 **Federal Register** (66 FR 41427).

#### 2. The Excluded Hospital and the Capital Market Basket

In this final rule, we are revising and rebasing the excluded hospital with capital market basket to a 1997 base year. We believe that using 1997 data, rather than 1992 data, to construct the IRF market basket allows us to more appropriately estimate increases in the costs of IRF goods and services from year to year. We believe the use of more recent data will ensure that our estimates more closely approximate the current costs of goods and services provided in IRFs.

The operating portion of the 1997-based excluded hospital with capital market basket is derived from the 1997-based excluded hospital market basket. The methodology used to develop the excluded hospital market basket operating portion was described in the August 1, 2002 **Federal Register** (67 FR 50042–50044). In brief, the operating cost category weights in the 1997-based excluded market basket added to 100.0. These weights were determined from the Medicare cost reports, the 1997 Business Expenditure Survey from the Bureau of the Census, and the 1997 Annual Input-Output data from the Bureau of Economic Analysis. In using the 1997 data, we made two methodological revisions to the 1997-based excluded hospital market basket: (1) Changing the wage and benefit price proxies to use the Employment Cost Index (ECI) wage and benefit data for hospital workers, and (2) adding a cost category for blood and blood products.

Previously we used a combination of several occupational ECIs in the 1992-based index such as the professional and technical workers, service workers, etc. We believe the ECI for hospital workers better represents the movement of hospital wages, salaries, and benefits and it is more reflective of current labor market conditions. For the 1992-based market baskets we were unable to find an adequate data source for the blood cost category.

For the 1997-based excluded hospital market basket, we were able to obtain these data from Medicare cost reports. As discussed in the IPPS August 1, 2002 final rule (67 FR 50035), BIPA required that we adequately reflect the price of blood and blood products in the

hospital market basket when it was rebased and revised, which was done for the FY 2003 IPPS payment rates. We believe this revision is also appropriate for the excluded hospital with capital market basket because it results in a more precise measure of the cost category for blood and blood products.

When we add the weight for capital costs to the excluded hospital market basket, the sum of the operating and capital weights must still equal 100.0. Because capital costs account for 8.968 percent of total costs for excluded hospitals in 1997, it holds that operating costs must account for 91.032 percent. Each operating cost category weight from the August 1, 2002 **Federal Register** (67 FR 50442–50444) was rebased to the 1997-based excluded hospital with capital market basket by multiplying by 0.91032 to determine its weight in the 1997-based excluded hospital with capital market basket.

The aggregate capital component of the 1997-based excluded hospital market basket (8.968 percent) was determined from the same set of Medicare cost reports used to derive the operating component. The detailed capital cost categories of depreciation, interest, and other capital expenses were also determined using the Medicare cost reports. As explained below, two sets of weights for the capital portion of the revised and rebased market basket needed to be determined. The first set of weights identifies the proportion of capital expenditures attributable to each capital cost category, while the second set represents relative vintage weights for depreciation and interest. The vintage weights identify the proportion of capital expenditures that is attributable to each year over the useful life of capital assets within a cost category (see IPPS final rule published in the August 1, 2002 **Federal Register** (67 FR 50046–50047) for a discussion of how vintage weights are determined).

The cost categories, price proxies, and base-year FY 1992 and FY 1997 weights for the excluded hospital with capital market basket are presented in Chart 3 “Excluded Hospital With Capital Input Price Index (FY 1992 and FY 1997) Structure and Weights.” Chart 4 “Excluded Hospital with Capital Input Price Index (FY 1997) Vintage Weights” presents the vintage weights for the 1997-based excluded hospital with capital market basket.