

CHART 5.—PERCENT CHANGES IN THE 1992-BASED AND 1997-BASED EXCLUDED HOSPITAL WITH CAPITAL MARKET BASKETS, FY 1999–2004—Continued

Fiscal year	Percent change, FY 1992-based market basket	Percent change, FY 1997-based market basket
2000 .....	3.4	3.1
2001 .....	3.9	4.0
2002 .....	2.7	3.6
Average historical .....	3.1	3.4
<b>Forecasts (FY 2003–2004)</b>		
2003 .....	3.4	3.8
2004 .....	2.9	3.2
Average forecast .....	3.2	3.5

Section 1886(j)(3)(c) requires that the increase in the IRF PPS payment rate be based on an “appropriate percentage increase in a market basket of goods and services comprising services for which payment is made under this subsection, which may be the market basket percentage increase described in subsection (b)(3)(B)(iii).” To date, we have used a market basket based on the cost structure of all excluded hospitals to satisfy this requirement, and have discussed in prior IRF rules why we feel this market basket provides a reasonable measure of the price changes facing exempt hospitals.

### 3. Research and Analysis

In its March 2002 Report, the Medicare Payment Advisory Commission (MedPAC) recommended the development of a market basket specific to IRF services. As we mentioned in the August 7, 2001 final rule, we researched the feasibility of developing such a market basket. This research included analyzing data sources for cost category weights, specifically the Medicare cost reports, and investigating other data sources on cost, expenditure, and price information specific to IRFs. As described in greater detail below, based on this research, we are not developing a market basket specific to IRF services at this time.

Our analysis of the Medicare cost reports indicates that the distribution of costs among major cost report categories (wages, pharmaceuticals, capital) for IRFs is not substantially different from the 1997-based excluded hospital with capital market basket we have used. In addition, the only data available to us were for these cost categories (wages, pharmaceuticals, and capital) presenting a potential problem since no other major cost category would be based on IRF data.

We conducted a sensitivity analysis of annual percent changes in the market

basket when the IRF weights for wages, pharmaceuticals, and capital were substituted into the excluded hospital with capital market basket. Other cost categories were recalibrated using ratios available from the inpatient PPS hospital market basket. On average, between the years 1995 through 2002, the excluded hospital with capital market basket increased at essentially the same average annual rate (2.9 percent) as the market basket with IRF weights for wages, pharmaceuticals, and capital (2.8 percent). In addition, in almost any individual year the difference was 0.1 percentage point or less, which is less than the 0.25 percentage point criterion that is used under the IPPS update framework to determine whether a forecast error adjustment is warranted.

The 0.25 percentage point criterion that determines whether a forecast error adjustment is warranted has been used in the IPPS update framework since the implementation of the IPPS. It serves as a guideline for the level of forecast accuracy, since any forecast is likely to contain enough imprecision that differences of one tenth or two-tenths of a percentage point are not thought to be significant. Thus, in this case if the forecast error is not at least greater than two-tenths of a percentage point, it is thought to be similar enough to the actual data as not to warrant an adjustment.

Based on the analysis described above, we continue to believe that the excluded hospital with capital market basket is doing an adequate job of reflecting the price changes facing IRFs. As additional cost data are being collected under the IRF PPS we hope that we will eventually be able to develop a market basket derived specifically from IRF data.

As shown in Chart 5, for the payment rates set forth in this final rule, the FY 2004 IRF market basket increase factor

using 1997 data is 3.2 percent. Thus, we apply the 3.2 percent increase, in addition to the budget neutral wage adjustment factor described below, to the FY 2003 standard payment conversion factor (\$12,193.00) to determine the 2004 standard payment conversion factor.

### 4. Updated Labor-Related Share

In implementing the FY 2002 and FY 2003 IRF PPS, we used the 1992 market basket data to determine the labor-related share (72.395 percent). As stated above, we are updating the 1992 market basket data to 1997. Doing so allows us to use the 1997-based excluded hospital market basket with capital costs to determine the FY 2004 labor-related share.

We calculated the FY 2004 labor-related share as the sum of the weights for those cost categories contained in the 1997-based excluded hospital with capital market basket that are influenced by local labor markets. These cost categories include wages and salaries, employee benefits, professional fees, labor-intensive services and a 46 percent share of capital-related expenses. The labor-related share for FY 2004 is the sum of the FY 2004 relative importance of each labor-related cost category, and reflects the different rates of price change for these cost categories between the base year (FY 1997) and FY 2004. The sum of the relative importance for FY 2004 for operating costs (wages and salaries, employee benefits, professional fees, and labor-intensive services) is 69.028 percent, as shown in Chart 6 “FY 2004 Labor-Related Share Relative Importance.” The portion of capital that is influenced by local labor markets is estimated to be 46 percent. Because the relative importance of capital is 7.604 percent of the 1997-based excluded hospital with capital market basket in FY 2004, we take 46 percent of 7.604 percent to