

diem rate to compute the provider's actual per diem PPS payment. XYZ's 12-month cost reporting period begins October 1, 2004. XYZ's total PPS

payment would equal \$20,379. The Labor and Non-labor columns are derived from Table 5. In addition, the adjustments for certain specified RUG—

III groups enacted in section 101(a) of the BBRA (as amended by section 314 of the BIPA) remain in effect, and are reflected in Table 9.

TABLE 9.—SNF XYZ: LOCATED IN STATE COLLEGE, PA

[Wage Index: 0.8705]

RUG group	Labor	Wage index	Adj. labor	Non-labor	Adj. rate	Percent adjustment	Medicare days	Payment
RVC	\$268.21	0.8705	\$233.48	\$82.98	\$316.46	\$337.66*	14	\$4,727
RHA	207.28	0.8705	180.44	64.13	244.57	260.96*	16	4,175
SSC	172.65	0.8705	150.29	53.41	203.70	244.44**	30	7,333
IA2	117.07	0.8705	101.91	36.22	138.13	138.13	30	4,144
Total	90	20,379

* Reflects a 6.7 percent adjustment from section 314 of the BIPA.

** Reflects a 20 percent adjustment from section 101(a) of the BBRA.

H. SNF Market Basket Index

1. Background

Section 1888(e)(5)(A) of the Act requires us to establish a SNF market basket index (input price index) that reflects changes over time in the prices of an appropriate mix of goods and services included in the SNF PPS. This final rule incorporates the latest available projections of the SNF market

basket index. Accordingly, we have developed a SNF market basket index that encompasses the most commonly used cost categories for SNF routine services, ancillary services, and capital-related expenses. In the July 31, 2001 **Federal Register** (66 FR 39562), we included a complete discussion on the rebasing of the SNF market basket to FY 1997. There are 21 separate cost categories and respective price proxies.

These cost categories were illustrated in Table 10.A, Table 10.B, and Appendix A, along with other relevant information, in the July 31, 2001 **Federal Register**.

Each year, we calculate a revised labor-related share based on the relative importance of labor-related cost categories in the input price index. Table 10 summarizes the updated labor-related share for FY 2004.

TABLE 10.—FY 2004 LABOR-RELATED SHARE

Cost category	FY 2003 Relative importance	FY 2004 Relative importance
Wages and Salaries	54.796	55.115
Employee Benefits	11.232	11.304
Nonmedical Professional Fees	2.652	2.651
Labor-Intensive Services	4.124	4.130
Capital-Related	3.324	3.172
Total	76.128	76.372

Source: (Table 10) Global Insights, Inc., DRI-WEFA, 4th Quarter, 2002.

2. Use of the SNF Market Basket Percentage

Section 1888(e)(5)(B) of the Act defines the SNF market basket percentage as the percentage change in the SNF market basket index, as described in the previous section, from the average index level of the prior fiscal year to the average index level of the current fiscal year. For the Federal rates established in this final rule, this percentage increase in the SNF market basket index is used to compute the update factor occurring between FY 2003 and FY 2004. We used the Global Insights, Inc. (formerly DRI-WEFA), 4th quarter 2002 forecasted percentage increase in the FY 1997-based SNF market basket index for routine, ancillary, and capital-related expenses, described in the previous section, to compute the update factor.

3. Market Basket Forecast Error Adjustment

In the supplemental proposed rule, we discussed the possibility of developing a market basket forecast adjustment to the rates. We solicited comments on—

- The appropriateness of making a cumulative market basket forecast adjustment reflecting underforecasts since the start of the SNF PPS;
- The continued use of this forecast error adjustment in future rate years;
- The appropriateness of applying a threshold to these annual rate adjustments; and
- Ways that we could use our authority to encourage industry innovation and monitor efforts to further promote quality improvement efforts among SNFs (see section III.L).

4. Federal Rate Update Factor

Section 1888(e)(4)(E)(ii)(IV) of the Act requires that the update factor used to establish the FY 2004 Federal rates be at a level equal to the full market basket percentage change. Accordingly, to establish the update factor, we determined the total growth from the average market basket level for the period of October 1, 2002 through September 30, 2003 to the average market basket level for the period of October 1, 2003 through September 30, 2004. Using this process, the market basket update factor for FY 2004 SNF Federal rates is 3.0 percent. In addition, as noted in the comments and responses shown below, the rates were adjusted by 3.26 percent to reflect the difference between the market basket forecast and the actual market basket increase from the start of the SNF PPS in July 1998.