

have not asserted that our policy to adjust the RVUs will resolve this issue. While the comments that our policy will increase payments for some service and decrease payments for payments for others are correct, we note that payments for services with high malpractice RVUs will increase the most in payment while there will be negligible impact on payment for most other services. Such a policy will improve our payment policies by giving more weight to the malpractice RVU in determining Medicare total payment consistent with the proportion that professional liability expenses represent of total physician expenses. As indicated in the impact section, services provided by cardiac and thoracic surgeons, neurosurgeons, orthopedic surgeons, vascular surgeons and emergency physicians are increasing in payment as a result of this proposal. There will be little impact of these adjustments on all other specialties.

### C. The Update Adjustment Factor

Section 1848(d) of the Act provides that the physician fee schedule update is equal to the product of the MEI and an "update adjustment factor" or UAF. The UAF is applied to make actual and target expenditures (referred to in the law as "allowed expenditures") equal. Allowed expenditures are equal to actual expenditures in a base period updated each year by the SGR. The SGR sets the annual rate of growth in

allowed expenditures and is determined by a formula specified in section 1848(f) of the Act.

#### 1. Calculation Under Current Law

Under section 1848(d)(4)(A) of the Act, the physician fee schedule update for a year is equal to the product of— (1) 1 plus the Secretary's estimate of the percentage increase in the MEI for the year, divided by 100 and (2) 1 plus the Secretary's estimate of the UAF for the year. Under section 1848(d)(4)(B) of the Act, the UAF for a year beginning with 2001 is equal to the sum of the following—

- Prior Year Adjustment Component. An amount determined by—
  - Computing the difference (which may be positive or negative) between the amount of the allowed expenditures for physicians' services for the prior year (the year prior to the year for which the update is being determined) and the amount of the actual expenditures for such services for that year;
  - Dividing that difference by the amount of the actual expenditures for such services for that year; and
  - Multiplying that quotient by 0.75.
- Cumulative Adjustment Component. An amount determined by—
  - Computing the difference (which may be positive or negative) between the amount of the allowed expenditures for physicians' services from April 1, 1996, through the end of the prior year

and the amount of the actual expenditures for such services during that period;

- Dividing that difference by actual expenditures for such services for the prior year as increased by the sustainable growth rate for the year for which the update adjustment factor is to be determined; and

- Multiplying that quotient by 0.33.

Section 1848(d)(4)(E) of the Act requires the Secretary to recalculate allowed expenditures consistent with section 1848(f)(3) of the Act. Section 1848(f)(3) specifies that the SGR (and, in turn, allowed expenditures) for the upcoming calendar year (2004 in this case), the current calendar year (2003) and the preceding calendar year (2002) are to be determined on the basis of the best data available as of September 1 of the current year. Allowed expenditures are initially estimated and subsequently revised twice. The second revision occurs after the calendar year has ended (that is, we are making the final revision to 2002 allowed expenditures in this final rule). Once the SGR and allowed expenditures for a year have been revised twice, they are final.

Table 13 shows annual and cumulative allowed expenditures for physicians' services from April 1, 1996 through the end of the current calendar year, including the transition period to a calendar year system that occurred in 1999.

TABLE 13

Period	Annual allowed expenditures (\$ in billions)	Cumulative allowed expenditures (\$ in billions)	FY/CY SGR
4/1/96–3/31/97 .....	48.9	48.9	N/A
4/1/97–3/31/98 .....	50.5	99.4	FY 1998 = 3.2%
4/1/98–3/31/99 .....	52.6	152.0	FY 1999 = 4.2%
1/1/99–3/31/99 .....	13.3	(1)	FY 1999 = 4.2%
4/1/99–12/31/99 .....	42.1	(2)	FY 2000 = 6.9%
1/1/99–12/31/99 .....	55.3	194.1	FY 1999/2000 <sup>3</sup>
1/1/00–12/31/00 .....	59.4	253.4	CY 2000 = 7.3%
1/1/01–12/31/01 .....	62.0	315.5	CY 2001 = 4.5%
1/1/02–12/31/02 .....	67.2	382.6	CY 2002 = 8.2%
1/1/03–12/31/03 .....	71.7	454.2	CY 2003 = 6.7%
1/1/04–12/31/04 .....	77.0	528.6	CY 2004 = 7.4%

<sup>1</sup> Allowed expenditures for the first quarter of 1999 are based on the FY 1999 SGR.

<sup>2</sup> Allowed expenditures for the last three quarters of 1999 are based on the FY 2000 SGR.

<sup>3</sup> Allowed expenditures in the first year (April 1, 1996–March 31, 1997) are equal to actual expenditures. All subsequent figures are equal to quarterly allowed expenditure figures increased by the applicable SGR. Cumulative allowed expenditures are equal to the sum of annual allowed expenditures. We provide more detailed quarterly allowed and actual expenditure data on our Web site under the Medicare Actuary's publications at the following address: <http://www.cms.hhs.gov/statistics/actuary/>. We expect to update the web site with the most current information later this month.

Consistent with section 1848(d)(4)(E) of the Act, table 13 includes our final revision of allowed expenditures for 2002, a recalculation of allowed expenditures for 2003, and our initial

estimate of allowed expenditures for 2004. To determine the update adjustment factor for 2004, the statute requires that we use allowed and actual expenditures from April 1, 1996 through

December 31, 2003 and the 2004 SGR. Consistent with section 1848(d)(4)(E), we will be making further revisions to 2003 and 2004 SGRs and 2003 allowed expenditures. Because we have