

continue and will be used to refine the proposed system.

In this proposed rule, as required under section 124 of the BBRA, we set forth the proposed Medicare prospective payment system for psychiatric hospitals and psychiatric units of acute care hospitals. We note that many hospitals have "psychiatric units," however; only those units that are separately certified from the hospital and meet the requirements of § 412.23, § 412.25, and § 412.27 are excluded from the hospital inpatient prospective payment system and would be subject to this proposed prospective payment system. Psychiatric units that are currently paid under the hospital inpatient prospective payment system and do not meet the requirements of § 412.22, § 412.25 and § 412.27 would not be paid under the proposed IPF prospective payment system. The proposed system includes an adequate patient classification system that would result in higher prospective payments to providers treating more costly, resource intensive patients using statistically objective criteria.

We are proposing to establish a base payment rate that would be paid to inpatient psychiatric facilities for each day of inpatient psychiatric care (the Federal per diem base rate). The proposed base rate would be adjusted by certain proposed patient-level and facility-level characteristics.

#### *B. Overview of the Payment System for Psychiatric Hospitals and Psychiatric Units Before the BBA*

##### 1. Description of the TEFRA Payment Methodology

Hospitals and units that are excluded from the hospital inpatient prospective payment system under section 1886(d)(1)(B) of the Act are paid for their inpatient operating costs under the provisions of Pub. L. 97-248 (TEFRA). The TEFRA provisions are found in section 1886(b) of the Act and implemented in regulations at 42 CFR Part 413. TEFRA established payments based on hospital-specific limits for inpatient operating costs. As specified in § 413.40, TEFRA established a ceiling on payments for hospitals excluded from the acute care hospital inpatient prospective payment system. A ceiling on payments is determined by calculating the product of a facility's base year costs (the year in which its target reimbursement limit is based) per discharge, updated to the current year by a rate-of-increase percentage, and multiplied by the number of total current year discharges. A detailed discussion of target amount payment

limits under TEFRA can be found in the final rule concerning the hospital inpatient prospective payment system published in the **Federal Register** on September 1, 1983 (48 FR 39746).

The base year for a facility varied, depending on when the facility was initially determined to be a prospective payment system-excluded provider. The base year for facilities that were established before the implementation of the TEFRA provision was 1982. For facilities established after the implementation of the TEFRA provision, facilities were allowed to choose which of their first 3 cost-reporting years would be used in the future to determine their target limit. In 1992, the "new provider" period was shortened to 2 full years of cost-reporting periods (§ 413.40(f)(1)).

Excluded facilities whose costs were below their target amounts would receive bonus payments equal to the lesser of half of the difference between costs and the target amount, up to a maximum of 5 percent of the target amount, or the hospital's costs. For excluded hospitals whose costs exceeded their target amounts, Medicare provided relief payments equal to half of the amount by which the hospital's costs exceeded the target amount up to 10 percent of the target amount. Excluded facilities that experienced a more significant increase in patient acuity could also apply for an additional amount as specified in § 413.40(d) for Medicare exception payments.

##### 2. BBA Amendments to TEFRA

The BBA amendments to section 1886 of the Act significantly altered the payment provisions for hospitals and units paid under the TEFRA provisions and added other qualifying criteria for certain hospitals excluded from the hospital inpatient prospective payment system. A complete explanation of these amendments can be found in the final rule concerning the hospital inpatient prospective payment system we published in the **Federal Register** on August 29, 1997 (62 FR 45966).

The BBA made the following changes to section 1886 of the Act for TEFRA hospitals:

- Section 4411 of the BBA amended section 1886(b)(3)(B) of the Act and restricted the rate-of-increase percentages that are applied to each provider's target amount so that excluded hospitals and units experiencing lower inpatient operating costs relative to their target amounts receive lower rates of increase.
- Section 4412 of the BBA amended section 1886(g) of the Act to establish a 15-percent reduction in capital

payments for excluded psychiatric and rehabilitation hospitals and units and LTCHs, for portions of cost reporting periods occurring during the period of October 1, 1997, through September 30, 2002.

- Section 4414 of the BBA amended section 1886(b)(3) of the Act to establish caps on the target amounts for excluded hospitals and units at the 75th percentile of target amounts for similar facilities for cost reporting periods beginning on or after October 1, 1997, through September 30, 2002. The caps on these target amounts apply only to psychiatric and rehabilitation hospitals and units and LTCHs. Payments for these excluded hospitals and units are based on the lesser of a provider's cost per discharge or its hospital-specific cost per discharge, subject to this cap.

- Section 4415 of the BBA amended section 1886(b)(1) of the Act by revising the percentage factors used to determine the amount of bonus and relief payments and establishing continuous improvement bonus payments for excluded hospitals and units for cost reporting periods beginning on or after October 1, 1997. If a hospital is eligible for the continuous improvement bonus, the bonus payment is equal to the lesser of: (1) 50 percent of the amount by which operating costs are less than expected costs; or (2) 1 percent of the target amount.

- Sections 4416 and 4419 of the BBA amended sections 1886(b) of the Act to establish a new framework for payments for new excluded providers. Section 4416 added a new section 1886(b)(7) to the Act that established a new statutory methodology for new psychiatric and rehabilitation hospitals and units, and LTCHs. Under section 4416, payment to these providers for their first two cost reporting periods is limited to the lesser of the operating costs per case, or 110 percent of the national median of target amounts, as adjusted for differences in wage levels, for the same class of hospital for cost reporting periods ending during FY 1996, updated to the applicable period.

##### 3. BBRA Amendments to TEFRA

The BBRA of 1999 refined some of the policies mandated by the BBA for hospitals and units paid under the TEFRA provisions. The provisions of the BBRA, which amended section 1886(b)(3)(H) of the Act, were explained in detail and implemented in the hospital inpatient prospective payment system interim final rule published in the **Federal Register** on August 1, 2000 (65 FR 47026) and in the hospital inpatient prospective payment system