

update factor would be equal to the market basket minus 0.25 percentage points for each percentage point in which operating costs are less than 10 percent over the target (but in no case less than 0 percent).

- For IPFs that are at or below their target amounts but exceed 66.7 percent of the target amounts, the update factor would be the market basket minus 2.5 percentage points (but in no case less than 0 percent).

- For IPFs that do not exceed 66.7 percent of their target amounts, the update factor would be 0 percent.

- For FYs 2003 and later, we use the most recent estimate of the percentage increase projected by the excluded hospital market-basket index.

In addition, since the proposed prospective payment system would include both the operating and capital-related costs, we needed to project the capital-related cost under the TEFRA system as well. We used the excluded capital market basket to project the capital-related costs under the TEFRA system. Table 5 below, summarizes the excluded hospital market basket and the excluded capital market basket indexes.

TABLE 5.—PROPOSED EXCLUDED HOSPITAL MARKET BASKET AND EXCLUDED CAPITAL MARKET BASKET

Fiscal year	Excluded hospital market basket percent	Excluded capital market basket percent
FY 1999	2.9	0.9
FY 2000	3.3	1.2
FY 2001	4.3	1.0
FY 2002	3.9	0.9
FY 2003* ...	3.7	0.8
FY 2004* ...	3.5	1.1
FY 2005* ...	3.2	1.1

*NOTE: Projected Percentage.

b. Estimate of Total Payments Under the TEFRA Payment System

We estimated payments for inpatient operating and capital services under the current TEFRA system using the following methodology:

Step 1: IPF's Facility-Specific Target Amount.

The facility-specific target amount for an IPF would be calculated based on the IPF's allowable inpatient operating cost per discharge for the base period, excluding capital-related, nonphysician anesthetist, and medical education costs. We would update this target amount using a rate-of-increase percentage as specified in § 413.40(c)(3)(viii).

From FYs 1998 through 2002, there were two national caps on the payment amounts for IPFs. As specified in

§ 413.40(c)(4)(iii), an IPF's facility-specific target is the lower of its net allowable base-year costs per discharge increased by the applicable update factors or the cap for the applicable cost reporting period. In determining each IPF's facility-specific target amount, we would use the labor-related and non-labor related shares of the national cap amounts for FY 2002 that appeared in the hospital inpatient prospective payment system final rule published in the **Federal Register** on August 1, 2001 (66 FR 39916). For existing IPFs (that is, IPFs paid under TEFRA before October 1, 1997), we adjusted the labor-related share (\$8,429) by the applicable geographic wage index and added that amount to the non-labor related share (\$3,351). For new IPFs (that is, IPFs first paid under TEFRA after October 1, 1997), we adjusted the labor-related share (\$6,815) and added that amount to the non-labor related share (\$2,709).

Step 2: IPF's Payment Amount for Inpatient Operating Services

Under the TEFRA system, an IPF's payment amount for inpatient operating services is the lower of—

- The hospital-specific target amount (subject to application of the cap as determined in Step (1) multiplied by the number of Medicare discharges (the ceiling); or

- The hospital's average inpatient operating cost per case multiplied by the number of Medicare discharges.

In addition, under the TEFRA system, payments may include a bonus or relief payment, as follows:

- IPFs whose net inpatient operating costs are lower than or equal to the ceiling, would receive the lower payment of either the net inpatient operating costs plus 15 percent of the difference between the inpatient operating costs and the ceiling; or the net inpatient operating costs plus 2 percent of the ceiling.

- IPFs whose net inpatient operating costs are greater than the ceiling, but less than 110 percent of the ceiling, would receive the ceiling payment.

- IPFs whose net inpatient operating costs are greater than 110 percent of the ceiling would receive the ceiling payment plus the lower of 50 percent of the difference between the 110 percent of the ceiling and the net inpatient operating costs or 10 percent of the ceiling payment.

Step 3: IPF's Payment for Capital-Related Costs

Under the TEFRA system, in accordance with section 1886(g) of the Act, Medicare allowable capital-related costs are paid on a reasonable cost basis.

Each IPF's payment for capital-related costs would be taken directly from the cost report and updated for inflation using the excluded capital market basket.

Step 4: IPF's Total (Operating and Capital-Related Costs) Payment Under the TEFRA Payment System

Once estimated payments for inpatient operating costs are determined (including bonus and relief payments, as appropriate), we would add the TEFRA adjusted operating payments and capital-related cost payments together to determine each IPF's total payments under the TEFRA payment system.

c. Payments Under the Proposed Prospective Payment System Without a Budget-Neutrality Adjustment

Payments under the proposed prospective payment system would be estimated without a budget-neutrality adjustment. We used \$562 (the average cost per day consistent with the average cost per day used in the regression model) as the starting point for the Federal per diem base rate. By applying the aggregate cost increase factor using the applicable market basket increase factors, we updated the base rate to the April 1, 2004 through June 30, 2005 period. The updated cost per day of \$671 was then used in the payment model to project future payments under the proposed IPF prospective payment system. The next step was to apply the associated proposed wage index and all applicable proposed patient-level and facility-level adjustments to determine the appropriate proposed prospective payment amount for each stay in the final payment model file.

We note that no separate wage or standardization factors were applied to the per diem amount used to derive the total proposed prospective payment system payments as these factors would be accounted for through the budget-neutrality computation described below. Thus, when the total proposed prospective payment system payments are compared to projected TEFRA payments, the resulting factor applied to the per diem amount would implicitly account for the effects of wage and standardization adjustments to the per diem costs.

d. Calculation of the Proposed Budget-Neutral Adjustment

In determining the proposed budget-neutrality factor, we compared the proposed prospective payment system amounts calculated from the psychiatric stays in the 1999 MedPAR file to the projected TEFRA payments from the