

2005 MEDICARE WAGE INDEX UPDATE

For FY 2005, the Centers for Medicare and Medicaid Services (CMS) redefined the labor market areas used to group hospitals for purposes of wage index calculation. FY 2005 wage index values are based on the 2000 census data, and introduce a new strategy for identifying urban areas, as explained below. Transition to these new wage indices has been difficult for both CMS and for the fiscal intermediaries (FIs). Reflecting these problems, wage index values have been corrected a number of times and the Provider Specific Files, which contain the data used to calculate hospital inpatient and outpatient prospective reimbursement, are still missing wage index information for more than 10% of acute care facilities.

BACKGROUND

Medicare adjusts payment under its various prospective payment systems (PPSs) for local differences in the cost of labor. This is accomplished by applying a wage index value to that portion of the case-specific payments considered to be labor-related. Wage index values indicate how the costs of labor in a specific geographic area compare to a national average. Wage index values greater than 1.0 indicate costs that are greater than the national average, whereas wage index values less than 1.0 indicate a less costly wage area. Wage index values are calculated from cost report data submitted by hospitals, with hospitals being grouped into urban and rural areas. Wage index values are initially calculated for the inpatient prospective payment system (IPPS), but are also applied to the outpatient prospective payment system (OPPS).

For the 2005 update to the IPPS and OPSS, CMS redefined the labor market areas used to group hospitals into urban and rural areas for purposes of wage index calculation. FY 2005 wage index values are based on the Office of Management and Budget's (OMB's) new Core-Based Statistical Areas (CBSAs), which were derived using 2000 census data. There are two categories of CBSAs: Metropolitan Statistical Areas, which are urbanized areas of 50,000 or more population, and Micropolitan Statistical Areas, which are urban clusters with populations of at least 10,000, but less than 50,000. CMS treats all hospitals *not* assigned to an MSA under new CBSA definitions, including hospitals in Micropolitan Statistical Areas, as rural, and applies the statewide rural wage index.

Implementation of the new MSA definitions has had a negative impact on a number of hospitals. The most dramatic impact is on hospitals previously considered urban that are now classified as rural. To reduce the negative impact of this reclassification and mitigate payment losses, CMS has allowed these hospitals to retain their FY 2004 MSA (urban) assignment and associated wage index for FY 2005, FY 2006 and FY 2007. In addition, CMS has implemented a 1-year transition blend for any hospital that due solely to changes in labor market definitions experienced a decrease in its FY 2005 wage index compared to the wage index that would have been calculated using FY 2004 labor market areas. These hospitals receive a blended index consisting of 50% of a wage index calculated using old labor market definitions (MSAs) and 50% of the wage index calculated using new labor market definitions (CBSAs).

In addition to the new CBSA-based labor market definitions, there were a number of other significant changes to the wage index for FY 2005:

- **Occupational Mix Adjustment:** Beginning October 1, 2004, CMS applied an occupational mix adjustment to the wage index to control for the effect of hospitals' employment choices on the wage index. The occupational mix adjustment ensures that varying labor costs are due to geographic differences in the costs of labor, not hospital management and staffing decisions. Because full implementation of an occupational-mix-adjusted wage index has a redistributive effect on Medicare payments to hospitals, CMS based the FY 2005 wage index on a blend consisting of 10% of an average hourly wage, adjusted for occupational mix, and 90% of an average hourly wage, unadjusted for occupational mix.
- **Adjustment Based on Commuting Patterns of Hospital Employees:** Section 505 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) mandated the adjustment of hospital wage indices based on commuting patterns of hospital employees. This adjustment increases the wage index for hospitals located in counties that have a relatively high percentage (at least 10%) of hospital employees who reside in the county but work in a different county with a higher wage index. These "outmigration" adjustments are effective for three (3) years beginning with discharges occurring on or after October 1, 2004 and do not apply to hospitals that have been reclassified for purposes of the wage index.
- **Other Wage-Index Adjustments:** Section 508 of the MMA allowed for a one-time reclassification of rural hospitals into urban areas for discharges between April 2004 and April 2007. These reclassified hospitals are exempt from the new CBSA-based wage index adjustments during those three years.

DETERMINATION OF THE WAGE INDEX

Wage index information for FY 2005 was initially presented in the August 1, 2004 IPPS final rule in the following tables¹:

TABLE	DESCRIPTION	PAGE NOS.
4A ₁	Wage Index and Capital Geographic Adjustment Factor (GAF) for Urban Areas by MSA	49448 – 49480
4A ₂	Wage Index and Capital Geographic Adjustment Factor (GAF) for Urban Areas by CBSA	49481 – 49521
4B ₁	Wage Index and Capital Geographic Adjustment Factor (GAF) for Rural Areas by MSA	49522 – 49523
4B ₂	Wage Index and Capital Geographic Adjustment Factor (GAF) for Rural Areas by CBSA	49524 – 49525
4C ₁	Wage Index and Capital Geographic Adjustment Factor (GAF) for Hospitals That Are Reclassified by MSA	49526 – 49530
4C ₂	Wage Index and Capital Geographic Adjustment Factor (GAF) for Hospitals That Are Reclassified by CBSA	49531 – 49536
4G	Pre-Reclassified Wage Index for Urban Areas	49538 – 49578
4H	Pre-Reclassified Wage Index for Rural Areas	49579 – 49580
4J	Wage Index Adjustment for Commuting Hospital Employees (Out-Migration) in Qualifying Counties – FY 2005	49580 – 49591

¹ See *Industry Insight 296, Medicare Pricer Changes for FY 2005* for additional information on the August 1, 2004 IPPS final rule.

Due presumably to the complexities of the transition to CBSAs, there were two updates to the above tables. The first update was described in an October 7, 2004 correction notice (***Federal Register***, pages 60242 – 60272), and the second in a December 30, 2004 correction notice (***Federal Register***, pages 78315 – 78335 and 78525 – 78717). Each correction involved a complete replacement of the above tables. Current wage index tables are available on the CMS web site (<http://www.cms.hhs.gov/providers/hipps/ippswage.asp>).

The above tables identify wage index values by geographic area. For urban areas, wage indices are by MSA and CBSA. Rural wage index values are published by state. CMS does not identify in published information or on their web site, which wage index values apply to specific hospitals. Identifying the appropriate wage index value for a specific facility is the responsibility of the facility's FI. It is the responsibility of each FI to submit the wage index values for their facilities to Medicare so they can be included in the various Pricers that CMS makes available on their website. Wage index values are posted to CMS's Provider Specific File (PSF), which is incorporated into the CMS Pricers and is used to calculate reimbursement under the IPPS, OPSS and other prospective payment systems. To assist the FIs with the complex FY 2005 update, CMS issued the following transmittals containing instructions on how to derive the appropriate wage index value for each Medicare-approved acute care facility:

- **Transmittal 309:** Transmittal 309 (*Fiscal Year (FY) 2005 Inpatient Prospective Payment System (IPPS), Long Term Care Hospital (LTCH) and Other Bill Processing Changes Related to the IPPS Final Rule*) was published October 1, 2004. It documented the changes in the October 7 2004 inpatient PPS correction notice, and included instructions for FIs to derive wage indices for specific facilities.
- **Transmittals 419 and 423:** Transmittal 419 (*January 2005 Update of the Hospital Outpatient Prospective Payment System (OPSS): Summary of Payment Policy Changes*) was published on December 30, 2004. It documented the changes from the December 30 2004 inpatient PPS correction notice, and included additional instructions to FIs for deriving the wage indices for specific facilities. Transmittal 419, including its attachments, was replaced by CMS in January 2005 with Transmittal 423 (same title). Transmittal 423 corrects errors in the wage index data.
- **Transmittal 422:** Transmittal 422 (*Update to FY 2005 Wage Index for Inpatient Prospective Payment System (IPPS) and Outpatient Prospective Payment System (OPSS) Hospitals*) was also published on December 30, 2004. It contained additional instructions related to wage index assignment for the OPSS. Wage indices, which took effect on October 1, 2004 for the IPPS, were implemented January 1, 2005 for the OPSS.

As documented in these transmittals, to derive the accurate wage index for each facility, the FIs needed to follow an intricate series of steps to:

- Identify the physical location of the facility,
- Assign the CBSA,
- Adjust for reclassifications,
- Evaluate eligibility for the 3-year waiver, the Section 505 adjustments, or the Section 508 reclassification,
- Check for further instructions on the Transmittals listed above, and
- Provide the appropriate wage index and associated information for each facility.

Because of the complexity of this process, CMS has allowed the FIs several extensions to the deadlines for filing PSF updates. Despite these extensions, the FIs have experienced difficulty correctly calculating and assigning wage index values for many facilities. This is evidenced by the

various Provider Specific Files that have been posted by CMS, along with several inpatient Pricer updates, during FY 2005.

- **October 2004:** As of October 1, 2004, there was no PSF containing the FY 2005 wage indices. The only file available containing the FY 2005 wage indices for specific facilities was the September 2004 Public Impact File, which contained preliminary wage index information for less than 4,000 facilities.
- **November 2004:** The first FY 2005 PSF was published November 8, 2004. This file was missing wage index information for 868 facilities.
- **February 2005:** The second FY 2005 PSF was published February 2, 2005 and then again on February 8, 2005. This most recent file is still missing valid wage index information for over 500 facilities. For these facilities, the CMS Pricer will not calculate accurate reimbursement.

CMS has not publicly identified which facilities have missing information, but did announce in Transmittal 422 that the April update to the CMS IPPS Pricer will include updates to the remaining facilities still not able to price due to missing wage index values or related data. Until then, although the FIs may be paying claims for these facilities, the payment amounts may not be accurate, and the PSFs do not reflect the data used to derive the wage-related information.

FOR FURTHER INFORMATION

Be sure to check the HSS web site (www.hssweb.com) for up-to-date information on Medicare regulatory changes, as well as changes to Medicare payment policies. **HSSweb** is updated on a regular basis with new and timely **Industry Insights**, as well as access to source documents.