

# MEMORANDUM

DATE: July 20, 2010

FROM: John Poisal, Deputy Director  
National Health Statistics Group  
Office of the Actuary

TO: Sheila Lambowitz, Director  
Division of Institutional Post Acute Care  
Chronic Care Policy Group

RE: Skilled Nursing Facility Fiscal Year 2009 Forecast Error

Thank you for your inquiry regarding the forecast error associated with the Fiscal Year (FY) 2009 Skilled Nursing Facility (SNF) market basket, as well as your question associated with the projected market basket update for FY 2011.

By way of background on the forecast error, in the FY 2011 SNF notice with comment regulation, CMS sets forth an update to the payment rates used under the prospective payment system for skilled nursing facilities.

*“The FY 2011 rates will be based on the rates that were finalized for FY 2010, as modified to reflect the **market basket adjustment, the forecast error adjustment, the applicable case-mix adjustment, and the parity adjustment.** As described in the final rule for FY 2008, the threshold percentage that serves to trigger an adjustment to account for market basket forecast error is 0.5 percentage point effective for FY 2008 and subsequent years. This adjustment takes into account the forecast error from the most recently available FY for which there is final data, and applies whenever the difference between the forecasted and actual change in the market basket exceeds a 0.5 percentage point threshold. For FY 2009 (the most recently available FY for which there is final data), **the estimated increase in the market basket index was 3.4 percentage points, while the actual increase was 2.8 percentage points, resulting in the actual increase being 0.6 percentage point lower than the estimated increase.** Accordingly, as the difference between the estimated and actual amount of change exceeds the 0.5 percentage point threshold, the payment rates for FY 2011 include a negative 0.6 percentage point forecast error adjustment.”[emphasis added]*

The final FY 2009 SNF market basket update of 3.4 percent was based on IHS Global Insight Inc. (IGI) second-quarter 2008 forecast (73 FR 46419, August 8, 2008) with historical data through first-quarter 2008, the most recent historical data at the time of the publication of the federal regulation. The market basket update factor is determined by calculating a weighted price index over time. The detailed calculations are performed using all available decimal places and then rounded to the nearest tenth of a decimal place for the official payment update factor (i.e. percentage increase in the SNF market basket) and forecast error calculations. Looking at the calculation using estimates that round to the nearest thousandth of a percentage point, as opposed to the nearest tenth of a percentage point, the difference between the projected growth and the actual growth for FY 2009 is 0.627 percentage point.

We have decomposed the aforementioned forecast error to provide additional details. Of the 0.6 percentage point forecast error, 0.5 percentage point was due to the over prediction of price inflation associated with two categories: Wages & Salaries and Benefits. Combined, these categories account for over 60 percent of the market basket cost weights. Both the Wages & Salaries and Benefits price proxy indexes are comprised of a 50/50-blend of the Employment Cost Index (ECI) for hospital workers (civilian) and the ECI for private nursing and residential care facilities, all of which grew slower than projected. The over-projected growth in these ECI's, as well as the over-

estimated growth in other price proxies (such as those used to proxy price growth in utilities) were largely a result of the steeper-than-expected depth of the economic slowdown that began in late 2007.

With respect to the coming year's update, using IGI's 2010 second-quarter forecast, we have confirmed that the FY 2011 update is 2.3 percent.

Please let me know if you have any additional questions regarding the market basket forecast error adjustments or the market basket calculations.