

October 1, 2018

The Honorable Douglas A. Ducey  
Governor of the State of Arizona  
1700 West Washington  
Phoenix, Arizona 85007

Dear Governor Ducey:

Laws 2013, First Regular Session, Chapter 202, Section 5 includes the following requirement:

For contract years 2015 through 2019, the Arizona health care cost containment system administration is required to report on the implementation of the new payment methodology authorized by this act, including any concerns raised by hospitals and any realized costs savings. The administration is required to submit its report by October 1 of each year to the governor, the president of the senate and the speaker of the House of Representatives, together with the chairpersons of the house and senate health committees.

In accordance with Laws 2013, First Regular Session, Chapter 202, the AHCCCS administration replaced its 20-year-old tiered per diem payment methodology with a diagnosis-related group (DRG) payment methodology effective October 1, 2014 for acute care hospitals. For the majority of in-state hospitals, the DRG base rate is a statewide standardized amount adjusted by hospital wage and labor indices to account for different geographic areas. The administration also adopted several policy adjustors which further modify reimbursement based on the nature of the service (e.g., newborn, obstetric, psychiatric), and an outlier add-on payment for claims which exceed established cost thresholds. The fiscal impact on each individual hospital of the transition to an APR-DRG payment methodology was phased in over a three-year period. Long-term acute care hospitals, rehabilitation hospitals, and psychiatric hospitals are excluded from the APR-DRG payment methodology and continue to be reimbursed by per diem rates.

During the three-year phase-in, the administration annually updated the cost-to-charge ratios that form a part of the outlier add-on calculation, and twice increased one of the policy adjustors to recognize the relative cost of high-acuity pediatric cases. The phase-in of the new reimbursement method was completed on September 30, 2017. The transition was occasioned by no major issues.

The administration performed its first rebase of the APR-DRG payment system effective for dates of discharge on and after January 1, 2018. For that purpose, the administration contracted with Navigant Consulting to provide assistance in analyzing various options and the potential fiscal impact of each. The administration also solicited and received input from hospital representatives.

Following is a summary of the key aspects of the APR-DRG rebase:

- Updated the inpatient reimbursement fiscal analysis to use data from federal fiscal year 2016, the most recent complete year of AHCCCS paid claims and adjudicated encounters at the time of rebasing;
- Updated the APR-DRG Grouper to 3M version 34;
- Updated the statewide standardized rates, as well as the wage and labor indices that modify the statewide standardized rates into hospital-specific base rates;
- Added two new policy adjustors, and increased the policy adjustor for high-acuity pediatric cases.

In addition, the structure of the APR-DRG rule was modified to remove specific reimbursement values and replace them with references to the reimbursement rate tables on the administration's website, together with authority to update the reimbursement values with public notice 30-days in advance of the updates. This change allows the administration to make updates to the APR-DRG reimbursement system without a formal rulemaking, providing the ability to be more responsive to medical coding and grouper updates as well as changes in law, policy, or industry trends which might impact inpatient hospital reimbursements.

Please feel free to contact Victoria Burns, Reimbursement Administrator, at (602) 417-4049 or via email at [Victoria.Burns@azahcccs.gov](mailto:Victoria.Burns@azahcccs.gov), if you have questions about this report or about the Inpatient Hospital APR-DRG reimbursement system.

Sincerely,



Thomas J. Betlach  
Director

cc: The Honorable Steve Yarbrough, President, Arizona State Senate  
The Honorable Javan D. Mesnard, Speaker, Arizona House of Representatives  
The Honorable Nancy Barto, Chairman, Senate Health and Human Services Committee  
The Honorable Heather Carter, Chairman House Health Committee  
Christina Corieri, Senior Policy Advisor, Arizona Governor's Office  
Matthew Gress, Director, Governor's Office of Strategic Planning and Budgeting  
Jami Snyder, Deputy Director, AHCCCS  
Richard Stavneak, Director, Joint Legislative Budget Committee