Arizona Long Term Care System (ALTCS),
Elderly and Physically Disabled (EPD) Actuarial Memorandum

I. Purpose

The purpose of this actuarial memorandum is to demonstrate that the Arizona Long Term Care System (ALTCS) Elderly and Physically Disabled (EPD) capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

Arizona Health Care Cost Containment System (AHCCCS) intends to update these capitation rates for January 1, 2013 to include changes to the physician fee schedule resulting from mandated Health Care Reform requirements and any other necessary changes.

II. Overview of Bid and Rate Setting Methodology

The contract year ending 2013 (CYE13) rates were developed as a rebase from the CYE12 rates accepted through an RFP process and approved by CMS. These rates represent the twelve month contract period October 1, 2012, through September 30, 2013.

EPD encounter data for CYE09, CYE10 and CYE11 comprised the experience base used in rate setting. This encounter data was made available to AHCCCS’ actuaries via an extract that provides utilization and cost data, referred to as the “databook”. Claims’ costs observed for all categories of service were then adjusted to reflect program changes and reimbursement reductions that were effective subsequent to the experience periods used, and the May 2012 termination of the EPD contract with the Senior Care Action Network (SCAN) health plan in Maricopa County. Prospective capitation rates for CYE13 are built up separately for members dually eligible for Medicare and Medicaid ("duals") and members not eligible for Medicare ("nonduals"). While CYE12 rates were not split out in this manner, the databook contained the information necessary to distinguish duals from non-duals and thus properly allocate their PMPM claim costs. The dual and non-dual prospective capitation rates are actuarially sound, as are the rates for the Prior Period Coverage (PPC) and Acute Care Only rate cohorts. Those cohorts are not split out into dual and non-dual rates.

Other data sources used in setting the actuarially sound rates and ranges include health plan financial statements and projected changes in HCBS placement.

Trend rates were calculated from the databook and other sources on a unit cost and/or utilization basis by category of service (COS). For more information on trends see Section IV Projected Trend Rates.

Ideally, the experience data should be analyzed by different rate cells which are comprised of members with similar risk characteristics. However, segregating the ALTCS population into different rate cells would lead to a statistical credibility problem due to the statewide disbursement of the relatively small membership base.
The ALTCS program has four rate cells: a prospective dual rate, a prospective non-dual rate, a prior period coverage (PPC) rate and an Acute Care Only rate. Capitation rates for the ALTCS population do not differ by gender and/or age, but do differ by Geographical Service Area (GSA).

The experience data includes only ALTCS Medicaid eligible expenses for ALTCS Medicaid eligible individuals, as well as reinsurance amounts. The Prior Period Coverage (PPC) rates are reconciled to a maximum 5% profit or loss.

The general process in developing the prospective rates involves:

- trending the base data, adjusted for program changes, to the midpoint of the effective period, which is April 1, 2013, and applying the projected mix percentage;
- making adjustments for share of cost offsets and, if applicable, any program changes;
- applying a deduction of the reinsurance offsets;
- adding the projected case management, administrative expenses, risk/contingency and premium tax to the projected claim PMPMs to obtain the capitation rates.

Each step is described in the sections below. There are also separate sections describing the PPC population and the Acute Care Only population.

III. Base Period Experience

AHCCCS used historical encounter data for the time period from October 1, 2008 through September 30, 2011. The data was reviewed and audited for accuracy, timeliness and completeness through encounter validation studies as well as studies comparing the encounter data to the contractors' financial statements. A final adjustment was to apply completion factors to the encounter data for the more recent years.

IV. Projected Trend Rates

The trend calculation is based on the time period from October 1, 2008 through September 30, 2011. The claim PMPMs were computed on a yearly basis and a trend factor was calculated. Trend factors are built up separately for dual, non-dual, PPC, and acute care. Trend factors also vary by COS. The trend rates developed were used to bring the base encounter data to the effective midpoint of the contract year.

Inherent in the encounter and financial data are unit cost trends which incorporate Contractors' Coordination of Benefits (COB) activities. AHCCCS provides Contractors with verified commercial and Medicare coverage information for their members which Contractors utilize to ensure payments are not made for medical services that are covered by the other carriers. When Contractors make a payment to cover members' coinsurance, deductibles, or Medicaid-covered services that are not covered by the other carriers, they submit encounters containing these reduced amounts. From state fiscal year (SFY) 2008 to SFY 2011, encounter-reported COB
cost avoidance grew by greater than 93%, from $130 million to $252 million. Additionally, ALTCS EPD Contractors cost-avoided $96 million in SFY 2011 in additional claims for which the Contractor had no financial obligation after the private insurance or Medicare payment was made. Consequently no encounters were submitted to AHCCCS and thus those services are excluded from capitation expenditure projections completely. AHCCCS continues to emphasize the importance of COB activities.

The trend rates used in projecting the claim costs by rate cell and category of service are identified in Table I.

<table>
<thead>
<tr>
<th></th>
<th>NF</th>
<th>HCBS</th>
<th>Acute</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prospective Dual</td>
<td>3.4%</td>
<td>1.0%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Prospective Non-Dual</td>
<td>2.5%</td>
<td>0.9%</td>
<td>-0.5%</td>
</tr>
<tr>
<td>PPC</td>
<td>1.7%</td>
<td>-3.0%</td>
<td>19.2%</td>
</tr>
</tbody>
</table>

V. **Projected Gross Claim PMPM**

The contract period for CYE13 rates is October 1, 2012, through September 30, 2013, so the midpoint is April 1, 2013. The claims’ PMPMs from the base data were trended to the midpoint of the CYE13 rate period.

VI. **Mix Percentage**

The CYE13 combined mix percentages are set using a combination of current placement percentages, program growth/saturation and the number of ALTCS members. These sources were reviewed by contractor and by county. The HCBS mix percentages can be found in Table II.

<table>
<thead>
<tr>
<th>GSA</th>
<th>County</th>
<th>Contractor</th>
<th>CYE12 HCBS Mix</th>
<th>CYE13 HCBS Mix</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Combined</td>
<td>Combined</td>
</tr>
<tr>
<td>40</td>
<td>Pinal/Gila</td>
<td>Bridgeway</td>
<td>75.42%</td>
<td>75.65%</td>
</tr>
<tr>
<td>42</td>
<td>LaPaz/Yuma</td>
<td>Evercare</td>
<td>60.09%</td>
<td>63.21%</td>
</tr>
<tr>
<td>44</td>
<td>Apache/Coconino/Mohave/Navajo</td>
<td>Evercare</td>
<td>67.44%</td>
<td>70.03%</td>
</tr>
<tr>
<td>46</td>
<td>Cochise/Graham/Greenlee</td>
<td>Bridgeway</td>
<td>61.40%</td>
<td>62.25%</td>
</tr>
<tr>
<td>48</td>
<td>Yavapai</td>
<td>Evercare</td>
<td>63.38%</td>
<td>63.97%</td>
</tr>
<tr>
<td>50</td>
<td>Pima/Santa Cruz</td>
<td>Evercare</td>
<td>67.74%</td>
<td>73.94%</td>
</tr>
<tr>
<td>50</td>
<td>Pima</td>
<td>Mercy Care</td>
<td>66.45%</td>
<td>66.82%</td>
</tr>
<tr>
<td>52</td>
<td>Maricopa</td>
<td>Bridgeway</td>
<td>78.02%</td>
<td>78.70%</td>
</tr>
<tr>
<td>52</td>
<td>Maricopa</td>
<td>Evercare</td>
<td>66.39%</td>
<td>71.03%</td>
</tr>
<tr>
<td>52</td>
<td>Maricopa</td>
<td>Mercy Care</td>
<td>75.42%</td>
<td>75.37%</td>
</tr>
<tr>
<td></td>
<td>Statewide Total</td>
<td></td>
<td>71.71%</td>
<td>73.15%</td>
</tr>
</tbody>
</table>
VII. **State Mandates, Court Ordered Programs, Program Changes and Other Changes**

**In-Lieu of Services**
Included in the base rates is funding for "in lieu of" services, substituting cost-effective alternative inpatient settings in place of more costly inpatient non-specialty hospital placements. State approved FFS rates at inpatient non-specialty hospitals are approximately 93.5% more expensive than those provided in alternative inpatient settings. The proposed capitation rates allow for the provision of services in alternative inpatient settings that are licensed by Arizona Department of Health Services/Arizona Licensing Services/Office of Behavioral Health License, in lieu of services in an inpatient non-specialty hospital, thus no increase to cap rates is included.

**340B Pharmacy Pricing**
Effective April 2012, all Contractors are required to reimburse claims for 340B drugs consistent with the requirements in AHCCCS Rule A.A.C. R9-22-710 C. In general, this provision requires that claims for drugs identified on the 340B pricing file dispensed by FQHCs and FQHC Look Alike pharmacies be reimbursed at the lesser of: 1) the actual acquisition cost or 2) the 340B ceiling price, plus a dispensing fee listed in the AHCCCS capped fee-for-service (FFS) schedule. For more detail regarding reimbursement of 340B drugs, please refer to the AHCCCS Rule. The estimated statewide savings to the EPD program was immaterial.

**Claims Processing Standards**
Effective January 1, 2012, Contractors were required to adjust their claims processing systems to recognize two cost-saving standards including multiple surgery occurrences and bundled services. When multiple surgeries occur on the same day, the surgery with the lowest cost is valued at 50% of the standard allowed amount for that surgery. Encounter data identified with status code B reflects bundled services where no additional payment is allowed for certain services that are performed together (e.g. anesthesia provided during an outpatient surgery). The estimated statewide savings to the EPD program was immaterial.

VIII. **Projected Net Claim PMPM**

The Nursing Facility and Home and Community Based Services projected gross claim PMPMs were adjusted for the mix percentages. The projected gross claims PMPMs were then discounted for the recipients' Share of Cost. The SOC component is fully reconciled with each Contractor. (The reinsurance offset is already included in the acute care component of the rates for the EPD population.) This calculation was performed separately for dual and non-dual members.
IX. **Case Management, Administrative Expenses and Risk Contingency**

The Case Management rates represent those rates awarded as part of the CYE12 RFP process, adjusted for expected growth in the HCBS mix, which would increase case management expenses. The administrative expenses also represent rates awarded as part of the RFP process. The risk contingency percentage remains the same as CYE12 at 1%.

X. **Proposed Capitation Rates and Their Impacts**

The proposed capitation rates for the EPD population equal the sum of the projected net claim PMPM (in Section VIII) and the projected case management, administrative expenses and risk contingency PMPM (in section IX) divided by one minus the two percent premium tax. Table III shows the proposed capitation rates for the EPD population statewide.

**Table III: Statewide Projected Net Capitation PMPM EPD Combined**

<table>
<thead>
<tr>
<th>Service Category</th>
<th>Gross CYE12 Rate</th>
<th>Mix</th>
<th>Net CYE12 Rate</th>
<th>Pct Gross Change</th>
<th>Net Pct Change</th>
<th>Gross CYE13 Rate</th>
<th>Net CYE13 Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nursing Facility (NF)</td>
<td>$5,211.34</td>
<td>28.29%</td>
<td>$1,474.51</td>
<td>9.2%</td>
<td>3.6%</td>
<td>$5,691.53</td>
<td>26.85%</td>
</tr>
<tr>
<td>Share of Cost</td>
<td>($224.20)</td>
<td></td>
<td>$229.70</td>
<td></td>
<td></td>
<td>($230.32)</td>
<td></td>
</tr>
<tr>
<td>Net Nursing Facility</td>
<td>$1,250.31</td>
<td></td>
<td>$1,250.31</td>
<td>3.8%</td>
<td></td>
<td>$1,297.59</td>
<td></td>
</tr>
<tr>
<td>Home/Community (HCBS)</td>
<td>$1,388.90</td>
<td>71.71%</td>
<td>$995.92</td>
<td>4.7%</td>
<td>6.8%</td>
<td>$1,453.53</td>
<td>73.15%</td>
</tr>
<tr>
<td>Case Management</td>
<td>$111.95</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$113.66</td>
<td></td>
</tr>
<tr>
<td>Acute Care</td>
<td>$370.09</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$327.22</td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td>$166.18</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$166.18</td>
<td></td>
</tr>
<tr>
<td>Risk Contingency</td>
<td>$30.87</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$31.46</td>
<td></td>
</tr>
<tr>
<td>Premium Tax</td>
<td>$59.70</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$61.21</td>
<td></td>
</tr>
<tr>
<td>Net Capitation PMPM</td>
<td>$2,985.03</td>
<td>2.5%</td>
<td></td>
<td></td>
<td></td>
<td>$3,060.64</td>
<td></td>
</tr>
</tbody>
</table>

Note: The product of the gross NF or HCBS rate and mix percentages as shown may not equal the net rate due to rounding.

XI. **Acute Care Only Members**

As in prior years, for members who are only eligible for acute care services in the ALTCS program, Contractors will be paid the acute care component plus the case management and administrative components. Since the reinsurance policy is the same for these members as for the other ALTCS members, the same reinsurance offset is appropriate.

XII. **Prior Period Coverage (PPC) Rates**

PPC rates cover the period of time from the effective date of eligibility to the day a member is enrolled with the Contractor. PPC rates are reconciled to a five percent profit/loss corridor.
AHCCCS used the actual PPC cost and PPC enrollment data for CYE09, CYE10 and CYE11 as the base in the development of the CYE13 PPC rates. Historical trends were developed and reviewed for appropriateness. Due to the relatively short PPC time period, AHCCCS' actuaries analyzed the data by combining rate cohorts or geographic regions to enhance statistical credibility when needed.

XIII. Proposed Capitation Rates and Budget Impact

Table IV includes the net capitation rates on a statewide basis for all rate cells as well as the estimated budget impact based off of CYE13 projected member months. The adjustments impact contractors ranging from -2.0% to +7.7%. Appendix I shows EPD rates by geographical service area and Contractor.

<table>
<thead>
<tr>
<th>Rate Cell</th>
<th>CYE13 Projected MMs</th>
<th>CYE12 Rate (5/1)</th>
<th>CYE13 Rate Capitation</th>
<th>Estimated CYE13 Capitation</th>
<th>Dollar impact on CYE12 estimated current capitation</th>
<th>Percent impact on CYE12 estimated capitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPD (Prospective)</td>
<td>308,155</td>
<td>$2,985.03</td>
<td>$3,060.64</td>
<td>$919,851,920</td>
<td>$943,151,519</td>
<td>$23,299,600</td>
</tr>
<tr>
<td>PPC</td>
<td>10,702</td>
<td>$907.74</td>
<td>$855.56</td>
<td>$9,714,633</td>
<td>$9,156,203</td>
<td>($58,430)</td>
</tr>
<tr>
<td>Acute Only</td>
<td>4,829</td>
<td>$530.13</td>
<td>$498.83</td>
<td>$2,559,998</td>
<td>$2,408,850</td>
<td>($151,148)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>$932,126,551</td>
<td>$954,716,572</td>
<td>$22,590,021</td>
</tr>
</tbody>
</table>

Note: Capitation estimates are based on CYE13 projected member months. The prospective rate is a member-weighted average of the prospective dual and non-dual rates shown in Appendix I.
XIV. CMS Rate Setting Checklist

1. Overview of rate setting methodology

   A.A.1.0: Overview of rate setting methodology

   AHCCCS is performing a rebase from the previously approved contract year ending 2012 (CYE12) rates under 42 CFR 438.6(c). Please refer to Section II.

   A.A.1.1: Actuarial certification

   Please refer to Section XV.

   A.A.1.2: Projection of expenditure

   Please refer to Section XIII.

   A.A.1.3: Procurement, prior approval and rate setting

   AHCCCS is operating under the Competitive Procurement contracting method.

   A.A.1.5: Risk contract

   The contract is an at risk contract.

   A.A.1.6: Limit on payment to other providers

   AHCCCS makes no additional payment to the providers, except for Disproportionate Share Hospital (DSH), Graduate Medical Education (GME) and Critical Access Hospitals. GME is paid in accordance with state plan. DSH and Critical Access Hospital payments are paid in accordance with Waiver Special Terms and Conditions. None of the additional payments to the providers were included in the capitation calculation.

   A.A.1.7: Rate modification

   Please refer to Sections III, IV, VI, VII, VIII, XI, XII, and XIII.

2. Base Year Utilization and Cost Data

   A.A.2.0: Base year utilization and cost data

   Please refer to Sections II and III.

   A.A.2.1: Medicaid eligibles under the contract

   There are dual eligibles.

   A.A.2.2: Speddown

   Not applicable, not covered under this contract.
AA.2.3: State plan services only

The contract between AHCCCS and the Contractors specifies that Contractors may cover additional services. Non-covered services were not included in the encounter data used to set the rates.

AA.2.4: Services that can be covered by a capitated entity out of contract savings.

Same as AA.2.3

3. Adjustments to the Base Year Data

AA.3.0 Adjustments to base year data

Please refer to Sections II and III.

AA.3.1 Benefit differences

Please refer to Section VII.

AA.3.2 Administrative cost allowance calculation

Please refer to Section IX.

AA.3.3 Special populations’ adjustment

It is anticipated that the risk characteristics of this population will not change materially from the base period to the effective period of the capitation rates. Therefore, no adjustment was made.

AA.3.4 Eligibility Adjustments

No adjustment was made.

AA.3.5 DSH Payments

No DSH payment was included in the capitation development

AA.3.6 Third party Liability (TPL)

This is a contractual arrangement between AHCCCS and the Contractors.

AA.3.7 Copayments, coinsurance and deductible in the capitated rates

EPD members do not pay any copays, coinsurance or deductibles, but some do pay SOC. See Section VIII.

AA.3.8 Graduate Medical Education (GME)

The experience excludes any payment for GME.

AA.3.9 FQHC and RHC reimbursement

The experience excludes any additional payments that FQHCs may receive from the State.
AA.3.10 Medical cost/ trend inflation

Please refer to Section IV.

AA.3.11 Utilization adjustment

Other than trend, no specific adjustment was made to utilization.

AA.3.12 Utilization and cost assumptions

Not applicable, since actual experience was used.

AA.3.13 Post-eligibility treatment of income (PETI)

Not applicable, not required to consider PETI.

AA.3.14 Incomplete data adjustment.

The CYE11 encounter data was not fully complete. AHCCCS assumed the data was approximately 94% complete and applied the appropriate completion factor to complete the CYE11 data. Completion estimates vary between dual and non-dual and by category of service. The audited financial statements may include outstanding claim liabilities, which were audited and believed to be reasonable by AHCCCS auditors.

4. Establish Rate Category Groupings

AA.4.0: Establish rate category groupings

Please refer to Section II.

AA.4.1: Age

Please refer to Section II.

AA.4.2: Gender

Please refer to Section II.

AA.4.2: Locality/region

Please refer to Section II.

AA.4.2: Eligibility category

Please refer to Section II.

5. Data Smoothing, Special Populations and Catastrophic Claims

AA.5.0: Data smoothing

Please refer to Sections II, III and IV.

AA.5.1: Special populations and assessment of the data for distortions
Data was not adjusted for special populations.

**AA.5.2: Cost-neutral data smoothing adjustments**
There was no cost-neutral data smoothing adjustments

**AA.5.3: Risk-adjustment**
No risk adjustment methodology is currently in place for the EPD population.

6. **Stop Loss, Reinsurance, or Risk-Sharing arrangements**

**AA.6.1: Commercial reinsurance**
There is no commercial reinsurance.

**AA.6.2: Simple stop loss program**
AHCCCS has a reinsurance program. Please refer to Section VIII and XI.

**AA.6.3: Risk corridor program**
There are reconciliations for PPC, HCBS and SOC.

7. **Incentive Arrangements**
At this time there are no incentive arrangements.
XV. **Actuarial Certification of the Capitation Rates**

I, Matt Varitek, am an employee of Arizona Health Care Cost Containment System (AHCCCS). I am a Member of the American Academy of Actuaries and a Fellow of the Society of Actuaries. I meet the qualification standards established by the American Academy of Actuaries and have followed the practice standards established from time-to-time by the Actuarial Standards Board.

The rates were developed using generally accepted actuarial principles and practices and are considered to be actuarially sound. The rates were developed to demonstrate compliance with the CMS requirements under 42 CFR 438.6(c) and are in accordance with applicable laws and regulations. The rates are appropriate for the Medicaid populations covered and Medicaid services to be furnished under the contract. The rates may not be appropriate for any other purpose. The documentation has been included with this certification. The actuarially sound capitation rates that are associated with this certification are effective for the twelve-month period beginning October 1, 2012.

The actuarially sound capitation rates are a projection of future events. It may be expected that actual experience will vary from the values in the rates.

In developing the actuarially sound capitation rates, I have relied upon data and information provided by the Program Contractors and the AHCCCS internal databases. I have accepted the data without audit and have relied upon the Program Contractors auditors and other AHCCCS employees for the accuracy of the data.

This actuarial certification has been based on the actuarial methods, considerations, and analyses promulgated from time to time through the Actuarial Standards of Practice by the Actuarial Standards Board.

Matthew C. Varitek

Date

Fellow of the Society of Actuaries
Member, American Academy of Actuaries
## Appendix I

<table>
<thead>
<tr>
<th>GSA</th>
<th>County</th>
<th>Contractor</th>
<th>EPD Dual</th>
<th>EPD Non-Dual</th>
<th>Acute Only</th>
<th>PPC</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>Pinal/Gila</td>
<td>Bridgeway</td>
<td>$3,075.66</td>
<td>$4,408.61</td>
<td>$619.91</td>
<td>$925.11</td>
</tr>
<tr>
<td>42</td>
<td>LaPaz/Yuma</td>
<td>Evercare</td>
<td>$2,875.27</td>
<td>$4,353.96</td>
<td>$521.03</td>
<td>$925.11</td>
</tr>
<tr>
<td>44</td>
<td>Apache/Coconino/Mohave/Navajo</td>
<td>Evercare</td>
<td>$2,453.31</td>
<td>$4,006.83</td>
<td>$487.31</td>
<td>$925.11</td>
</tr>
<tr>
<td>46</td>
<td>Cochise/Graham/Greenlee</td>
<td>Bridgeway</td>
<td>$2,825.76</td>
<td>$3,758.81</td>
<td>$438.19</td>
<td>$925.11</td>
</tr>
<tr>
<td>48</td>
<td>Yavapai</td>
<td>Evercare</td>
<td>$3,169.44</td>
<td>$4,373.13</td>
<td>$491.28</td>
<td>$925.11</td>
</tr>
<tr>
<td>50</td>
<td>Pima/Santa Cruz</td>
<td>Evercare</td>
<td>$2,776.78</td>
<td>$4,118.94</td>
<td>$378.70</td>
<td>$784.36</td>
</tr>
<tr>
<td>50</td>
<td>Pima</td>
<td>Mercy Care</td>
<td>$2,975.30</td>
<td>$4,562.90</td>
<td>$430.77</td>
<td>$784.36</td>
</tr>
<tr>
<td>52</td>
<td>Maricopa</td>
<td>Bridgeway</td>
<td>$2,464.57</td>
<td>$4,701.30</td>
<td>$429.91</td>
<td>$844.98</td>
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<td>$2,742.17</td>
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<td>$844.98</td>
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<td>$562.22</td>
<td>$844.98</td>
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