I. Purpose

This memorandum presents a discussion of the revision to the capitation rates for the Children’s Rehabilitative Services (CRS) program, for the period October 1, 2011 to September 30, 2012. This revision to the rates is required primarily due to changes effective October 1, 2011 resulting from the Governor’s Medicaid Reform Plan. The purpose of this actuarial memorandum is to demonstrate that the updated capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

II. Overview of Rate Setting Methodology

The contract year ending 2012 (CYE12) rates were developed as a rate update from the contract year ending 2011 (CYE11) capitation rates as adjusted April 1, 2011 and previously approved by CMS. The CYE12 rates cover the twelve month contract period of October 1, 2011 through September 30, 2012.

The assumed trend rates were developed from an internal data extract (“databook”) that tracks historical enrollment, as well as utilization counts and unit costs for encounters adjudicated by AHCCCS. Other data sources include health plan financial statements, anticipated Arizona Health Care Cost Containment System (AHCCCS) Fee For Service rate changes, anticipated Arizona Department of Health Services (ADHS) transportation increases, programmatic changes, and BLS statistics on medical inflation.

CRS enrollees are classified into three different risk groups, high, medium and low, based on the medical condition that drives their initial eligibility for CRS enrollment. Prior to CYE12, separate capitation rates were developed for each risk group. Beginning in CYE12, a single PMPM capitation rate will be implemented, using a member-weighted average of the current CYE11 rates as a starting point. AHCCCS believes this adjustment to a single capitation rate will add to the credibility of the CRS capitation rates. The average CYE11 rate is then trended forward to the midpoint of the contract year, or April 1, 2012 and adjusted for provider reimbursement changes and other changes. In the final step, the projected administrative expenses, risk/contingency margin, reinsurance offset and premium tax are added to the projected claim per member per month values (PMPMs) to obtain the capitation rates. Each step is described in the sections below.
III. Projected Trend Assumptions and Provider Reimbursement Adjustments

Utilization and unit cost trend rates were calculated from the encounter data experience for CYE09 and CYE10 dates of service. CYE09, CYE10, and CYE11 (YTD) Financials were used to validate encounter data and trends. Adjustments to the encounter data were made for the observed change in enrollment distribution between the risk groups. The resulting average PMPM trend of 4.1% was applied to all categories of service, except Clinic Fees as they represent overhead expenses and infrastructure costs which are not expected to follow this trend.

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 through SFY 2010, encounter-reported COB cost avoidance grew from $34,000 in SFY 2008 to $889,000 in SFY 10. Additionally, the CRS Contractor cost-avoided almost $9 million 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.

As part of the Governor’s Medicaid reform plan, and pursuant to Laws 2011, Chapter 31, AHCCCS is given the authority to reduce fee schedule rates for all providers up to 5%. Therefore, effective October 1, 2011, AHCCCS will reduce all provider reimbursement, with few exceptions, by 5%, including all payment ratios utilized for provider reimbursement (e.g., all Cost-to-Charge Ratios (CCRs), By Report Percentages (BR), etc.). The decreases total approximately $4.4 million statewide.

The Hospital Outpatient and Emergency Room trend rate was then adjusted for the rebase of the Outpatient Fee Schedule (OPFS) rates required by the Arizona Administrative Code. This rebase is required every five years and will be effective October 1, 2011. The rebase results in an increase of approximately $1,516,000.

IV. State Mandates, Court Ordered Programs, Program Changes and Other Changes

Transition of Pediatric Costs
Effective June 1, 2011, St. Joseph’s Hospital and Phoenix Children’s Hospital (PCH) united the two organizations’ pediatric programs at PCH for patients through age 14. AHCCCS' outpatient hospital Fee-For-Service rates for PCH are, in aggregate, higher than the payment rates for St. Joseph’s Hospital. AHCCCS used historical encounter data to determine the fiscal impact of this alliance by extracting cost and utilization data for pediatric services at St. Joseph’s and repricing them at the PCH rates.
Because many of the services may be performed at other Phoenix-area hospitals, AHCCCS included only fifty percent of the increase in the capitation rates. The impact is an increase of approximately $925,000.

**Hospital Outliers**

As part of the Governor's Medicaid reform plan, and pursuant to Laws 2011, Chapter 31, language authorizing inpatient outlier payments was eliminated and AHCCCS was provided the authority to establish reimbursement methodologies "notwithstanding any other law." AHCCCS chose to maintain an outlier payment methodology for one year— with modifications—effective October 1, 2011. Those modifications include:

- Increasing cost thresholds by 5 percent; and
- Reducing CCRs by a percentage equal to a hospital’s increase to its charge master based on any/all increases since April 1, 2011.

The impact of these changes is a savings of approximately $815,600.

**Transportation**

Reductions to transportation rates effective October 1, 2011, are included in the Governor’s Medicaid reform plan and authorized in Laws 2011, Chapter 31. This brings the AHCCCS reimbursement of ADHS-regulated ambulance rates to 68.59% of the approved rates. In accordance with this legislation, ambulance rate increases approved by ADHS after July 1 annually will not be included in AHCCCS’ October 1 fee schedule until the following year in order to provide AHCCCS predictability in expenditures. Since ADHS approved ambulance rate increases (as requested by providers) through July 1, 2011, the impact of this reduction is less than the full 5%, at 4.8%.

V. **Prospective Projected Net Claim PMPM**

The CYE11 utilization, unit costs and net claims PMPMs are trended forward and adjusted for AHCCCS fee schedule changes, state mandates, court ordered programs and program changes to arrive at the CYE12 utilization, unit costs and net claims PMPMs.

VI. **Projected Reinsurance Offsets**

The CYE11 reinsurance offsets were reviewed by AHCCCS for appropriateness and reasonableness using reinsurance encounter and payment information. Appropriate adjustments were made to the reinsurance offsets based upon this review.

VII. **Proposed Administrative Expenses and Risk Contingency**

The administrative expense remains at 9.64% for general administration, which was determined to be appropriate to cover the contractors' average expenses. The risk contingency load also remains the same at 2%.
VIII. Proposed Revised Capitation Rates and Their Impact

The proposed capitation rates equal the sum of the projected net claim PMPM (in Section V) less the reinsurance offsets (in section VI) and the projected administrative expenses and risk contingency PMPM (in section VII), divided by one minus two percent for premium tax. Table I below summarizes the changes from the current approved CYE11 capitation rates and the estimated budget impact, effective for CYE12 on a statewide basis.

Table I. Proposed Statewide Capitation Rates and Budget Impact

<table>
<thead>
<tr>
<th></th>
<th>Based on Projected Member Months October 1, 2011 - September 30, 2012</th>
<th>CYE11 (4/1) Current Rate</th>
<th>CYE12 Updated Rate</th>
<th>Based on Projected Member Months October 1, 2011 - September 30, 2012</th>
<th>Estimated CYE11 (4/1) Current Capitation</th>
<th>Estimated CYE12 Updated Capitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statewide Totals</td>
<td>307,062</td>
<td>$417.35</td>
<td>$424.10</td>
<td>$128,151,376</td>
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<td>Dollar Impact</td>
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<td>Percentage Impact</td>
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<td></td>
<td></td>
<td>1.62%</td>
<td></td>
</tr>
</tbody>
</table>
IX. CMS Rate Setting Checklist

1. Overview of rate setting methodology

A.A.1.0: Overview of rate setting methodology

AHCCCS is performing a rate update from the rates in effect for contract year ending 2011 (CYE11) as adjusted April 1, 2011 and previously approved by CMS, under 42 CFR 438.6(c). Please refer to Section II.

A.A.1.1: Actuarial certification

Please refer to Section X.

A.A.1.2: Projection of expenditure

Please refer to Section VIII.

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

AHCCCS is operating under the Sole Source contracting method.

A.A.1.5: Risk contract

The contract is an at risk contract, however there are some provisions for reinsurance.

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

AHCCCS makes no additional payment to 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 the Waiver Special Terms and Conditions. None of the additional payments to providers were included in the capitation calculation.

A.A.1.7: Rate modification

Please refer to Sections II through IV, VI and VI.
X. **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, 2011.

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 health plan and the AHCCCS internal databases. I have accepted the data without audit and have relied upon the health plan 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
Fellow of the Society of Actuaries
Member, American Academy of Actuaries

Date: 09-01-2011