

AHCCCS Rates: Providing Fair and Adequate Funding

The Issue

In response to budget shortfalls associated with the Great Recession, Arizona lawmakers approved a series of hospital payment cuts under the Arizona Health Care Cost Containment System (AHCCCS). For 2014, the impact of these cuts is over \$800 million—a revenue loss of 35 percent for Arizona hospitals compared to 2010 payments. According to a report by Milliman, Inc., AHCCCS pays hospitals approximately 70 percent of cost as a result of these cuts.

AzHHA's Position

Hospitals should be fairly and adequately compensated for the care provided to AHCCCS members. Without sufficient compensation, hospitals are forced to shift costs to businesses and private pay patients. Smaller rural and safety net hospitals, which have disproportionately high Medicare and Medicaid utilization, are particularly vulnerable to shortfalls because there is less opportunity to shift costs. In these cases, hospitals must often reduce or shutter services, or possibly align with other organizations, which can impact local control of healthcare decision making.

Background

As outlined in the following table, lawmakers approved, and the AHCCCS Administration implemented, a series of payment cuts to hospitals beginning in FFY 2009. Specifically, rates were frozen beginning Oct. 1, 2008, and then cut by 5 percent on Oct. 1, 2010 and by another 5 percent on Apr. 1, 2011. Other policy changes included reductions to outlier and disproportionate share hospitals (DSH) payments, and the imposition of a 25 day inpatient benefit limit. For 2014, these cuts total \$800.3 million, a revenue loss which has been incorporated into the new APR-DRG payment methodology. As part of the regulation implementing the APR-DRG system, the AHCCCS Administration also eliminated the inflation factor that was part of the previous tiered per diem statute. As such, there is no longer a statutory mechanism for recognizing and funding the cost of inflation.

**AHCCCS Rates:
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Hospital Payment Cuts Since 2008

Note	Description	Dollar Amount	Percentage
(1)	AHCCCS FFY 2010 inpatient and outpatient payments	2,260,513,309	
(2)	Estimated 2010 impact of outlier model change	82,700,000	
(3)	Rate freezes:		
(a)	10/1/2008		3.6%
(b)	10/1/2009		2.1%
(c)	10/1/2010		2.6%
(d)	10/1/2011		3.0%
(e)	10/1/2012		2.6%
(f)	10/1/2013		2.5%
(g)	Cumulative Lost Rate Increases		17.6%
(4)	Impact of eliminating rate increases on hospital payments	396,834,355	
(5)	October 2010 5 percent rate cut impact	113,025,665	
(5)	April 2011, 5 percent rate cut impact	113,025,665	
(6)	Impact of imposing 25 day limit effective 10/1/2011	77,817,532	
(7)	State funded DSH reduction	16,862,200	
(8)	Total reductions	800,265,418	
(9)	Percentage impact on 2014 payments		35%
(10)	State general fund savings	262,246,978	

Notes:

- Figure is the sum of *AHCCCS Outpatient Payments 2010* and *AHCCCS Inpatient Payments 2010*, located on the **AHCCCS Hospital Payment Summary** document located at <http://www.azahcccs.gov/commercial/downloads/HospitalSupplements/AZHospitalPayments.pdf>
- AHCCCS Outlier Report to JLBC (November 2006)* projects 2010 expenditures at \$253.4M without the Outlier change, and \$170.7M with the Outlier change, resulting in the \$82.7M reported in the schedule.
- Each rate increase from 10/2008 - 10/2013 is identified in the *Actual Regulation Market Basket Updates* provided by CMS at <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-reports/MedicareProgramRatesStats/downloads/mktbskt-actual.pdf>
- The figure is the product of (2) and (3)(g)
- The figure is the product of 5% and (1)
- Figures provided by AHCCCS in personal correspondence with AzHHA
- AHCCCS provides historical DSH payments at the hospital level. In 2009, DSH payments from AHCCCS were 26.1M. In 2011, DSH payments from AHCCCS dropped to \$9.3M.
- This figure is the sum of (4) - (7)
- This figure is the ratio of (8) divided by (1)
- The 11/30/2013 Federal Register identifies the Arizona FMAP at 67.23%. The State General fund savings is calculated by multiplying (9) by the 33.77 (the difference between 1005 and the FMAP)

AHCCCS Rates: Providing Fair and Adequate Funding

Analysis

In the wake of these AHCCCS rate freezes and cuts, Arizona hospitals are paid approximately 70 percent of the cost of treating AHCCCS members.¹ Such underpayments mean hospitals must either shift costs to commercial payers and self-pay patients or reduce costs through the reduction or elimination of services. In the most extreme cases, hospitals may need to shutter all services, file for bankruptcy protection and/or seek additional capital investment through strategic partnership with or acquisition by larger healthcare systems. Because smaller rural and safety net hospitals have disproportionately high Medicare and Medicaid utilization, they are less able to cost-shift, and thus are more vulnerable to the latter course of action.

Financial Vulnerability Remains despite Medicaid Expansion

While the recent restoration of Prop. 204 and Medicaid expansion has begun to stabilize hospital uncompensated care², hospitals face an uncertain financial future due to a number of factors:

- **The shift to high deductible health plans with narrower networks** Over the past few years, more and more employers have shifted to high deductible insurance plans as a way to reduce premium costs. This trend has been reinforced with the roll-out of qualified health plans under the Affordable Care Act. Unfortunately, many patients are ill-prepared to take on the financial obligations associated with these health plans, and hospitals are absorbing an increasing amount of bad debt, particularly from patients who receive out-of-network care.
- **The loss of Safety Net Care Pool (SNCP) funding** The SNCP program was established by the Arizona Legislature in FY 2012. The program has allowed eligible providers to use monies from political subdivisions to draw down federal matching funds to offset the uncompensated costs of medical services provided to AHCCCS members and the uninsured. Funding from the program has helped to offset underpayments by AHCCCS, which—as noted previously—pays hospitals on average about 70 percent of

¹ John Pickering and David C. Lewis. *Arizona Medicaid Access to Hospital Care – 2013 Evaluation*, p. 2. Prepared by Milliman, Inc. for The Arizona Health Care Cost Containment System. June 28, 2012. The authors estimate that for the statewide hospital payment-to-cost ratio would be 0.705 in FY 2013 with the exclusion of the Safety Net Care Pool payments. These payments have since been eliminated.

² Based on monthly data that Arizona hospitals submit to AzHHA, uncompensated care was 4.9% for November 2014 compared with 7.9% for November 2013 and 7.1% for November 2012.

AHCCCS Rates: Providing Fair and Adequate Funding

cost. The SNCP program terminated on January 1, 2014, and it is unclear whether CMS would approve its continuation for most hospitals moving forward.³

- **The high cost of technology and labor** The primary cost-drivers in the healthcare industry are labor and technology. Hospitals rely on highly skilled nurses, physicians and allied health professionals to deliver care; and care is delivered in an increasingly technologically-intensive environment. Shifts in the labor market and expensive medical technology continue to put pressure on hospital budgets. These are costs that simply cannot be “downsized.” All payers, including AHCCCS, must help shoulder these costs, as all patients are entitled to receive the same high quality of care.
- **Regulatory costs** Whenever a nurse, physician or other caregiver treats a patient, a host of regulations and statutes govern their actions, especially if the patient is a Medicare or Medicaid beneficiary. More than 30 federal agencies and a dozen state agencies and/or accrediting organizations oversee some aspect of the health care delivery process. While no one questions the need for regulations to ensure safe patient care, the regulatory environment has become exceedingly difficult and costly to navigate. This is particularly true as healthcare providers transition to new models of care delivery and payment reform.
- **Shift to more risk based payment models** Hospitals and payers are experimenting with new delivery system and payment models that reward quality and efficiency. Rather than receiving a fee for each procedure performed or service delivered, payment is tied to performance measures and outcomes. Medicare has implemented several of these value-based purchasing models in recent years, and AHCCCS is moving in this direction as well. These models hold much promise for improving quality and controlling cost, but there is also much unpredictability for providers since more risk is shifted to them. In order for these models to reach their full statewide potential, providers must have budgetary room to implement them.

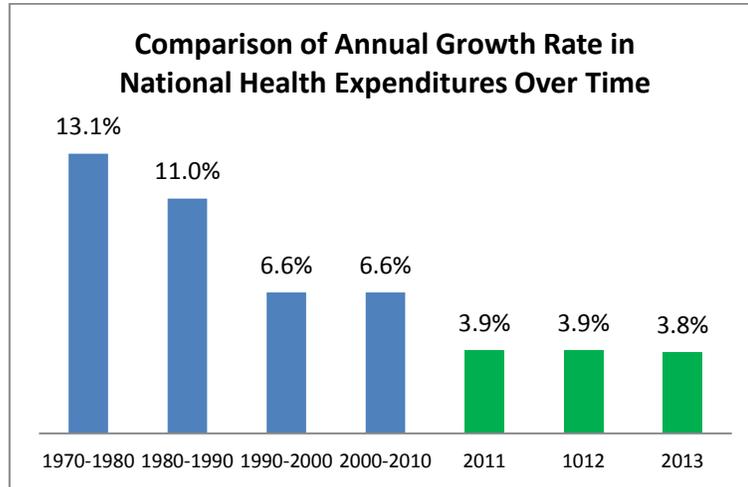
Arizona is a Leader in Cost Containment

In response to decreasing revenues and delivery system reforms, hospitals have moved assertively in recent years to improve cost containment and overall value.

³ The State Legislature approved continuation of the program through 2017 for Phoenix Children’s Hospital and Indian Health Services and 638 Tribal facilities. CMS approved a waiver request for SNCP funding for these hospitals through Dec. 31, 2014, and on August 29, 2014 AHCCCS submitted an additional waiver request for these hospitals through December 31, 2015.

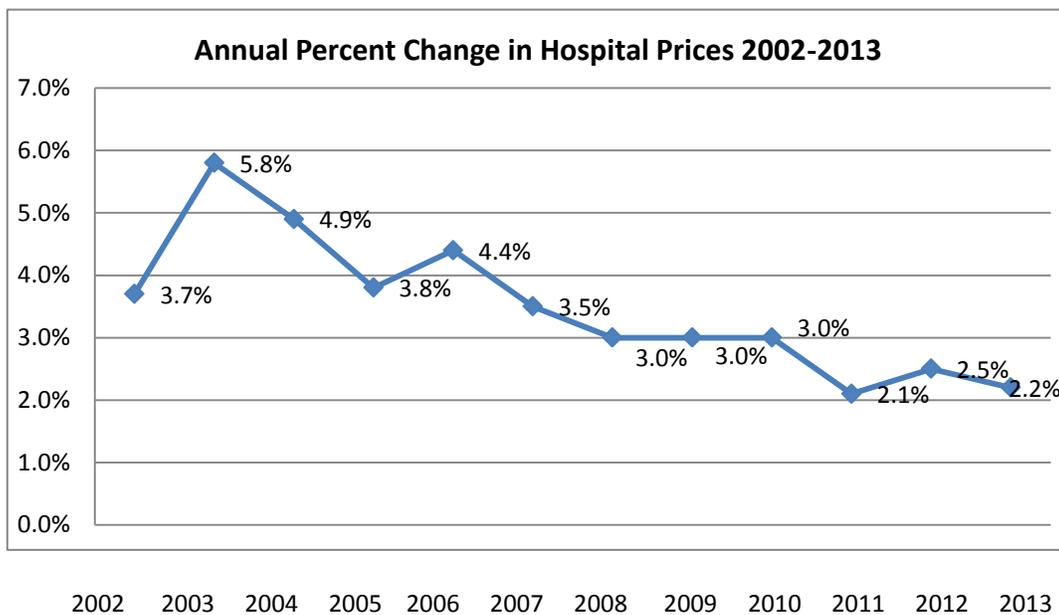
**AHCCCS Rates:
Providing Fair and Adequate Funding**

In fact, as depicted in the chart below, national healthcare spending is at historically low levels.



Source: CMS Office of the Actuary. *National Health Expenditures Accounts*. September 2013

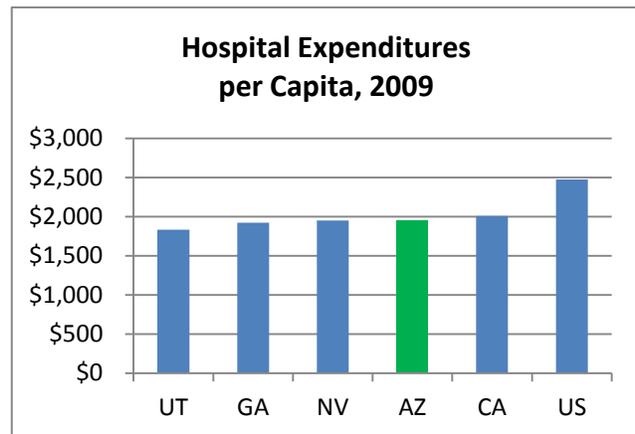
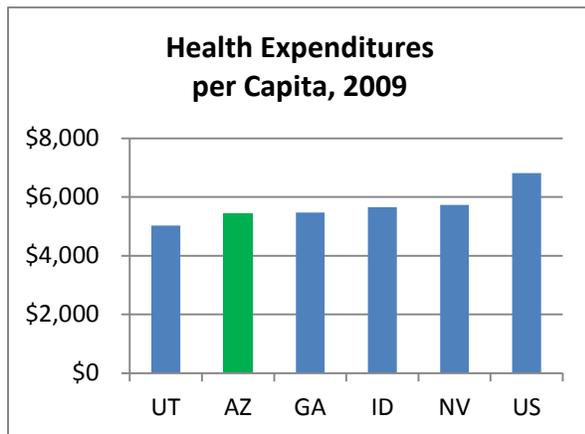
Spending from 2011 through 2013 has averaged about 3.9 percent—compared to the historical average of 9.3 percent since 1961. This trend is evident across Medicare and Medicaid. And, while some of the slowdown is likely due to a sluggish economy, researchers believe structural changes in healthcare delivery and payment reform are playing a role.⁴ As shown in the chart below, slower growth in hospital prices is also contributing to this trend.



⁴ See, for example, *Medical Cost Trends: Behind the Numbers 2015*. PwC Health Research Institute. June 2014.

AHCCCS Rates: Providing Fair and Adequate Funding

Significantly, Arizona is a leader in containing healthcare costs. Arizona is the second lowest state in both healthcare expenditures per capita and the rate of growth in those expenditures, as well as the fourth lowest in hospital expenditures per capita.



Source: Kaiser State Health Facts

Our Position

Arizona hospitals have worked diligently over the past several years to contain costs. They are among the most efficient providers in the nation and are well-positioned to drive value into the future. But they must have the budgetary room to implement additional delivery system and payment reforms if the promise of this future is to be realized.

Not only does the existing AHCCCS rate structure not take into account inflation, it is based on rates in effect as of FY 2007 **minus** 10 percent. While AzHHA supports efforts by the AHCCCS Administration to transition to new value-based delivery system and payment models, it is imperative that payment rates reflect more closely the current cost of care.