DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
7500 Security Boulevard, Mail Stop S2-01-16
Baltimore, Maryland 21244-1850

State Demonstrations Group

October 6, 2015

Mr. Thomas Betlach
Director
Arizona Health Care Cost Containment System
801 East Jefferson Street
Phoenix, AZ 85034

Dear Mr. Betlach:

This letter is to inform you that the Centers for Medicare & Medicaid Services (CMS) has received Arizona's Safety Net Care Pool Transition Plan for Phoenix Children's Hospital that provides details toward the state moving toward long term payment reforms for the hospital. This transition plan was required in the Special Terms and Conditions (STC) for its section 1115 of the Social Security Act (the Act) demonstration, Arizona's Health Care Cost Containment System (AHCCCS), (Project No. 11-W-00275/09) and 21-W-00064/9).

CMS accepts Arizona's transition plan and the plan is currently under review.

If you have any questions regarding this letter, or other questions regarding the AHCCCS 1115 demonstration, please do not hesitate to contact your project officer, Ms. Jessica Woodard at (410) 786-9249 or Jessica.Woodard@ccms.hhs.gov.

We look forward to continuing to partner with you and your staff on the AHCCCS demonstration.

Sincerely,

/s/

Andrea J. Casart
Acting Director
Division of Medicaid Expansion Demonstrations

cc: Henrietta Sam-Louis, Acting Associate Regional Administrator, CMS San Francisco

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Phoenix Children's Hospital Safety Net Care Pool Transition Report

July 2015

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BACKGROUND

In April 2012, CMS approved the Safety Net Care Pool (SNCP) program designed to help hospitals with managing the burden on uncompensated care costs. This was approved at a time when the State had frozen new enrollment for its childless adult category (0-100% FPL). Many hospitals across the State participated in the SNCP, and the program proved to be incredibly valuable as a bridge to 2014. The program ended on December 31, 2013, in anticipation of the State's restoration of childless adult coverage and addition of new coverage for adults 100-133% FPL. However, SNCP was extended for Phoenix Children's Hospital (PCH) to address issues unique to freestanding children's hospitals that did not benefit from adult coverage restoration and expansion. Subsequently, PCH received two one-year extensions of SNCP.

During 2014, AHCCCS contracted with Public Consulting Group to conduct an independent evaluation of the use of SNCP funds prior to and after the January 1, 2014 extension period, an analysis of factors that contributed to the necessity of SNCP, and an analysis of the findings and conclusions drawn from the factors that contributed to the necessity of SNCP. Public Consulting Group made a number of observations and conclusions.

- PCH serves a population with a high rate of Medicaid coverage and a low proportion of uninsured patients in comparison to safety net hospitals.
- Before and after implementation of the ACA reforms, the uninsured have constituted a marginal group within the hospital's overall payer mix, with no significant changes in the proportion of "self-pay" clients over the past five years.
- Analysis revealed an 83% growth in overall uncompensated care costs between FFY 2011 and FFY 2012. This increase in costs is due to a number of causal factors introduced in that year, including major changes in PCH volumes, higher patient acuity, and significant rate reductions implemented by AHCCCS.
- Although PCH's financial picture in 2014 remains incomplete, some of the factors driving the hospital's higher uncompensated care since 2011 have been mitigated, if not eliminated. It appears that the effort to contain Medicaid costs is increasingly effective, and that the care delivery system has become more closely aligned with the payment system and new reimbursement rates established by AHCCCS.
- The hospital's Medicaid shortfall is the unique consequence of a convergence between the State's cost containment efforts and PCH's high quality, high cost delivery system. Public Consulting Group also states: "The high cost of care at the hospital is not merely a function of higher patient acuity, but must also be placed within the wider context of PCH's ambitious organizational growth and its aspirations to be a national leader in high quality pediatric care, equipped with cutting-edge medical technology, attracting top physician talent, and producing highly-respected research."
- While SNCP does not represent a permanent solution to assuring adequate Medicaid cost coverage to the hospital, it continues to serve as an essential mechanism for transitioning PCH to the post-ACA health care environment.
- SNCP funding has not adversely affected the hospital's capability or willingness to achieve greater efficiencies. Rather, they appear to have facilitated the hospital's ongoing movement in this direction, allowing PCH the budgetary room to implement additional efficiencies, including value-based delivery system and payment reforms, without substantially disruptive effects on the hospital's level of quality. For this reason, extension of SNCP authorization appears justifiable.

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Public Consulting Group's full report can be found on the agency's website at: http://www.azahcccs.gov/reporting/Downloads/1115waiver/Doc2AZ_SNCP_Eval_Report_FINAL.pdf.

In addition to last year's report, AHCCCS contracted with Navigant Consulting to analyze the cost per inpatient discharge at Phoenix Children's Hospital compared to selected other children's hospitals including those located in Alabama, California, Florida, Illinois, Minnesota, and Washington. These hospitals were chosen because of the ease of obtaining data. After adjusting for the differences in hospital specific Medicaid case-mix index and regional wage differences, as well as adjusting for inflation to make hospital years comparable, the average cost per discharge ranged from $11,204 to $27,377. The average cost per discharge at PCH was $17,416, which was slightly below the average of $17,536 and slightly above the median of $16,823. The full analysis is attached.

PCH has also presented to AHCCCS a study conducted by the Children's Hospital Association that compared costs of 32 children's hospitals across the country. This study indicated PCH's cost of delivering care was 15% below the nationwide mean.

TRANSITIONING AWAY FROM SNCP: SHORT AND LONG-TERM OPPORTUNITIES

The State is committed to working with PCH to move away from total reliance on SNCP. However, the State also recognizes that this transition cannot be achieved overnight. The State has committed to taking immediate action steps that will help PCH lessen its current SNCP reliance, as well as identified longer term goals to achieve a more complete transition away from SNCP.

Current AHCCCS Payment Reforms

APR-DRG Payment Methodology

On October 1, 2014, AHCCCS transitioned from a tiered per diem inpatient reimbursement system to an APR-DRG payment system to further AHCCCS' goals of enhancing quality of member care and promoting efficient delivery of services. AHCCCS contracted with Navigant Consulting to provide assistance in analyzing, acquiring and implementing a DRG-based inpatient hospital payment system, and sought and received an abundance of input from impacted hospitals on implementing the new payment methodology in a budget neutral fashion. Navigant Consulting estimated that the change in payment methodology would **result in an increase in payments of $9,704,392 for PCH**, which will be phased in over two years, achieving full implementation in the third year of APR-DRG.

Reimbursements for High-Acuity Pediatric Cases

Beginning with discharges on and after January 1, 2016, AHCCCS will address the costs associated with high-acuity pediatric services at all hospitals by increasing reimbursement for pediatric cases with Severity of Illness (SOI) levels 3 and 4 under the APR-DRG system. This change is projected

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to increase reimbursements to inpatient hospitals by nearly $20 million annually. The projected **impact to Phoenix Children's Hospital is an annual increase of $10,059,405**.#

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Other Payment Reforms and Solutions

While AHCCCS is committed to ensuring a transition away from SNCP, and is working to increase reimbursement rates to PCH outside of the SNCP program, any payment reforms to PCH must be taken in the larger context of the AHCCCS program as a whole. This is particularly challenging at a time when Arizona is still recovering from the Great Recession. Due to a continued budget shortfall, Arizona's State Fiscal Year 2016 budget included language which allowed AHCCCS to reduce rates for providers up to 5% in aggregate for Federal Fiscal Year 2016. Based on information received from providers and associations representing thousands of providers statewide, AHCCCS worked to find alternative solutions to a rate reduction while still living within the Legislature's lower appropriation for the program that factored in a 5% rate reduction. The resulting reimbursement rate strategy for FY 2016 includes some rate increases in areas identified as critical, among them the high-acuity pediatric cases discussed above.

AHCCCS requests a five year transition away from SNCP payments whereby SNCP payments are reduced, from a maximum of $137 million in 2015 to $117 million in 2016, $90 million in 2017, $70 million in FY 2018, $50 million in 2019 and $25 million in 2020. During this phase-out period, AHCCCS will continue to implement solutions designed to account for the high-quality, high-cost services provided by PCH without adversely impacting other providers. Ultimately, any final reform needs to be multi-faceted and include increases in Medicaid reimbursement as well as a continued focus by PCH on achieving greater efficiencies.

Some potential solutions appear below:

Graduate Medical Education Funding

AHCCCS intends to revise the Arizona Administrative Code detailing the Graduate Medical Education distribution process for the purpose of updating the method for determining a hospital's Indirect Medical Education (IME) costs. This change has the potential to increase IME funding by more than $81,000,000 annually for Arizona training hospitals. The **projected impact to Phoenix Children's Hospital is an annual increase of $12,500,000**. As Arizona is currently under a rule-making moratorium, the change will require approval from the governor's office in order to proceed. Including Executive approval and factoring in the typical rulemaking process timeframe, this change could not be implemented any sooner than one year.

Value Based Purchasing

Under consideration for an effective date of October 1, 2016, AHCCCS registered Arizona hospitals that meet AHCCCS established value based performance metrics requirements (yet to be determined) may receive a Value Based Purchasing (VBP) Differential payment for both inpatient and outpatient hospital services. The purpose of the VBP Differential is to incentivize and reward facilities that have committed to supporting designated actions that improve patient care and health outcomes, and reduce cost of care growth. Preliminary analysis suggests PCH would likely be eligible for a VBP differential under any approach yet considered.

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Increased Reimbursements for High-Acuity Pediatric Cases

AHCCCS will continue to evaluate whether additional increases for pediatric cases with Severity of Illness (SOI) levels 3 and 4 under the APR-DRG system should be made beyond the increase that will take place in January.

Other Delivery System Reform Opportunities

AHCCCS continues to develop opportunities for delivery system reform, which would support PCH's continued work to improve the efficiency and quality of the care received by its patients both in the hospital and throughout the community. These options include, but are not limited to, support for care coordination and integrated care efforts.

AHCCCS
Analysis of Cost per Discharge for Children's Hospitals

State	Medicare Provider ID	Hospital Name	Claims Data Begin Date	Claims Data End Date	APR-DRG Grouper Version	APR-DRG Case Mix[1]	Wage Index[2]	Labor Portion	Inflation Factor[3]	Average Cost Per Discharge[4]	Inflated Average Cost Per Discharge	Average Cost Per Day	Average Cost Per Discharge Adjusted for Wage Index	Average Cost Per Discharge Adjusted for Wage Index and Case Mix
						A	B	C	D	E	F = E*(1+D)	G	H = ((F*C/B)+ (F*(1-C)))	G = F/A
Arizona	033302	Phoenix Children's Hospital	1/1/2014	12/31/2014	31	1.1867	1.0412	0.696	0.0%	$ 21,254.30	$ 21,254.30	$ 4,045.21	$ 20,668.94	$ 17,417.16
Alabama	013301	USA Women's and Children's Hospital	10/1/2012	9/30/2013	31	0.6440	0.7542	0.620	2.4%	$ 5,862.00	$ 6,002.69	$ 1,154.80	$ 7,215.61	$ 11,204.36
California	N/A	Loma Linda University Medical Center	1/1/2009	12/31/2009	29	1.3397	1.2477	0.696	11.5%	$ 15,900.00	$ 17,728.50	$ 1,947.86	$ 15,278.89	$ 11,404.71
California	N/A	Child Hosp-Ctrl CA	1/1/2009	12/31/2009	29	1.2225	1.2477	0.696	11.5%	$ 16,954.22	$ 18,903.96	$ 2,264.29	$ 16,291.93	$ 13,326.73
California	053302	Children's Hospital of Los Angeles	1/1/2009	12/31/2009	29	1.7059	1.2477	0.696	11.5%	$ 25,861.42	$ 28,835.48	$ 2,849.35	$ 24,851.18	$ 14,567.78
Minnesota	243302	Children's Health Care	1/1/2013	12/31/2013	31	1.7012	1.0979	0.696	1.9%	$ 26,746.12	$ 27,254.30	$ 3,247.33	$ 25,562.83	$ 15,026.35
California	053304	Children's Hospital -Orange County	1/1/2009	12/31/2009	29	1.3864	1.2477	0.696	11.5%	$ 22,338.03	$ 24,906.90	$ 3,207.28	$ 21,465.43	$ 15,482.85
California	N/A	Children's Hospital & Research Center	1/1/2009	12/31/2009	29	0.9888	1.6439	0.696	11.5%	$ 18,955.25	$ 21,135.10	$ 2,884.69	$ 15,373.32	$ 15,547.45
California	053303	Rady Children's Hospital -San Diego	1/1/2009	12/31/2009	29	1.2335	1.2477	0.696	11.5%	$ 20,443.70	$ 22,794.73	$ 3,648.70	$ 19,645.10	$ 15,926.31
Florida	103301	Nicklaus Children's Hospital	7/1/2013	6/30/2014	30	1.3790	0.7980	0.620	1.3%	$ 19,355.15	$ 19,606.77	$ 3,134.98	$ 22,683.90	$ 16,449.53
Florida	103300	All Children's Hospital	7/1/2013	6/30/2014	30	1.9900	0.8986	0.620	1.3%	$ 30,887.34	$ 31,288.88	$ 2,823.67	$ 33,477.91	$ 16,823.07
Illinois	143302	Shriners Hospital for Children	7/1/2013	6/30/2014	30	1.6950	1.0276	0.696	1.3%	$ 29,546.40	$ 29,930.50	$ 8,421.09	$ 29,370.99	$ 17,327.96
Illinois	143300	Lurie Children's Hospital	7/1/2013	6/30/2014	30	1.4640	1.0276	0.696	1.3%	$ 28,303.10	$ 28,671.04	$ 4,612.17	$ 28,135.07	$ 19,217.59
California	053309	E & L Miller Child Hosp	1/1/2009	12/31/2009	29	0.6282	1.2477	0.696	11.5%	$ 13,237.45	$ 14,759.76	$ 2,148.96	$ 12,720.35	$ 20,248.89
California	053305	Lucile Salter Packard Children's Hospital	1/1/2009	12/31/2009	29	0.9178	1.6650	0.696	11.5%	$ 23,635.57	$ 26,353.66	$ 4,316.66	$ 19,027.82	$ 20,731.99
Minnesota	243300	Gillette Children's Hospital	1/1/2013	12/31/2013	31	1.5968	1.0979	0.696	1.9%	$ 35,072.57	$ 35,738.95	$ 5,502.60	$ 33,520.90	$ 20,992.55
Alabama	013300	The Children's Hospital of Alabama	10/1/2012	9/30/2013	31	1.0730	0.8294	0.620	2.4%	$ 19,866.00	$ 20,342.78	$ 3,352.79	$ 22,937.07	$ 21,376.58
Washington	503301	Mary Bridge Children's Hospital	7/1/2010	6/30/2011	31	1.1820	1.1220	0.696	7.7%	$ 27,003.52	$ 29,082.79	$ 6,749.13	$ 26,881.83	$ 22,742.66
Washington	503300	Seattle Children's Hospital	7/1/2010	6/30/2011	31	1.6590	1.1349	0.696	7.7%	$ 45,975.18	$ 49,515.27	$ 4,923.15	$ 45,418.87	$ 27,377.26

Notes:
1. Case mix based on each State's APR-DRG grouper version's national weights. Note national weights in different grouper versions are on different scales.
2. Based on Medicare wage index in effect during the claims data period. Note that Medicare wage indices in different years are on different scales.
3. Inflation factors are calculated by determining the change in the hospital market basket index level from the midpoint of the claims data period to the midpoint of calendar year 2014. The hospital market basket index levels are based on quarterly HIS Global Insight index level data released by CMS.
4. Estimated costs based on varied approaches (either detailed revenue code costing or aggregate CCR-based costing) across states in this analysis.