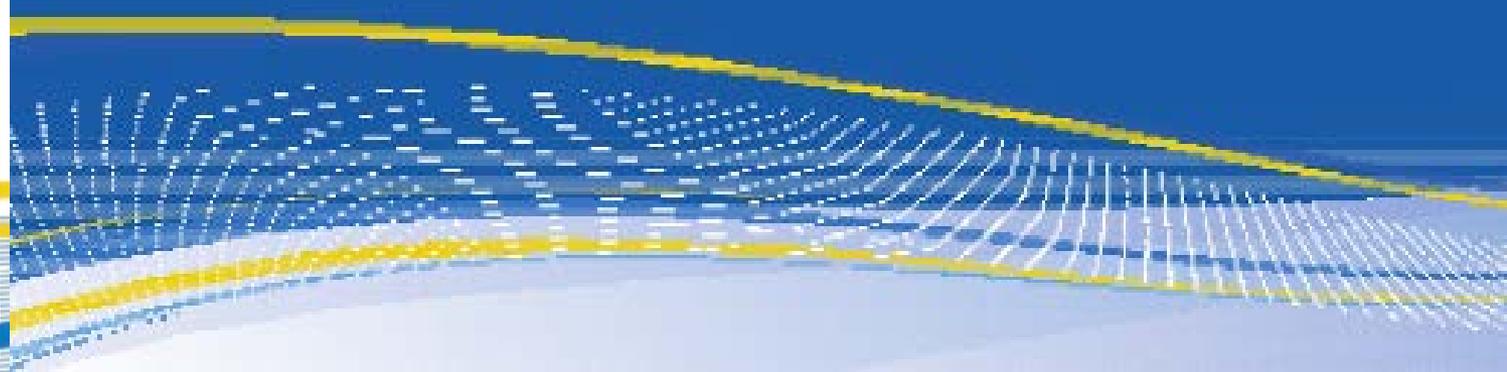




# Cost Neutrality

Division of Long Term Services and Supports  
Disabled and Elderly Health Programs Group  
Center for Medicaid and CHIP Services



# Training Objectives

- Understand the basics of the cost neutrality formula used in 1915(c) waiver applications.
- Review Appendix J and describe how the states can better explain the method used to calculate the estimates.
- Understand various inflationary indices and discuss how each is used in Appendix J-2-c and J-2-d.

# Basic Formula for Cost Neutrality

## Purpose

- §1915(c)(2)(D) of the SSA requirement: “State must assure that the average per capita expenditure under the waiver during each waiver year not exceed 100 percent of the average per capita expenditures that would have been made during the same year for the level of care provided in a hospital, nursing facility, or ICF/IDD under the state plan had the waiver **not** been granted.”
- Ensures waiver program costs are less than (or equal to) the cost of institutional programs for the same population enrolled in a home and community-based services (HCBS) waiver.

# Factors of the Cost Neutrality Formula

## §1915 (c) Waiver Technical Guide Definitions.

- Appendix J-1 describes the cost neutrality of the waiver.
- **Factor D:** Estimated annual average per capita Medicaid cost for home and community-based services for individuals in the waiver program.
- **Factor D':** Estimated annual average per capita Medicaid cost for all other services provided to individuals in the waiver program.
- **Factor G:** Estimated annual average per capita Medicaid cost for hospital, NF, or ICF/IID care that would be incurred for individuals served in the waiver, were the waiver not granted (average cost for institutional services for individuals with the same level of care).
- **Factor G':** Estimated annual average per capita Medicaid costs for all services other than those included in factor G for individuals served in the waiver, were the waiver not granted.

## Formula for Cost Neutrality.

- $D + D' \leq G + G'$

# Appendix J and Cost Neutrality

## Appendix J-2: Derivation of Estimates.

- States provide information about how the estimate for each cost neutrality formula factor has been derived.
- The following sub-sections will be specifically discussed in this training:
  - Appendix J-2-a: Number of Unduplicated Participants.
  - Appendix J-2-b: Average Length of Stay (ALOS).
  - Appendix J-2-c: Derivation of Estimates of Each Factor.
  - Appendix J-2-d: Estimation of Factor D.

# Appendix J-2-a: Unduplicated Participants

- The total number of unduplicated participants is part of the factor D. These individuals are counted only once even if they are discharged from the waiver multiple times during the year.
- Example of methods used to estimate unduplicated participants.
  - States submit annually a CMS-372 report that documents actual cost neutrality data.
  - Trending historical 372(s) data forward to estimate the percentage increase from year-to-year.
  - Developing an estimate based on similar waiver programs' characteristics and estimates.
  - Creating or updating estimates based on waiver program updates (i.e. lowering the minimum age, expanding financial eligibility, etc.).
- The state can establish a cap based on their budgetary resources.

# Appendix J-2-b: Average Length of Stay (ALOS)

- A statistic that describes the number of days on average during a waiver year that an individual participates in the waiver.
- What affects ALOS?
  - Participant turnover (e.g., death, relocation, discharge, etc.)
    - Cumulative number of days the individual participates in the waiver is factored into participant turnover regardless of whether the individual has left the waiver during the year.
  - Phase-in / phase-out of the waiver. (See slide 9 for more information.)

# Appendix J-2-b: Average Length of Stay (ALOS)

- Some waivers will naturally have a higher ALOS due to the types of services offered and the needs of the eligible population. For example:
  - Waivers serving children who will naturally age out of the waiver, as opposed to individuals with ID/DD who generally continue long-term on a waiver.
  - Individuals with traumatic brain injury may need short term treatment to develop coping skills that will allow them to live without supports.

# Basis for ALOS Estimate - Options

## How to Document ALOS Basis

- Explain the specifics supporting the state's reasoning for the ALOS estimate.

## Common Approaches Used by States

- **CMS-372(s) Data**
  - State analyzes trends from previous years and projects these trends forward in the estimate.
- **Phase In / Phase Out**
  - Waiver changes that result in a waiver expanding its participant base to accept more participants, or phasing out a previous program, will have a direct impact on participant turnover, directly affecting ALOS.

# Basis for ALOS Estimate - Options

## Common Approaches Used by States (continued)

### ➤ Experience from Similar Waivers

- States examine similar waivers within their own state or in other states with similar demographic target populations.
- This method is often helpful when establishing a new waiver.
- If this approach is used, the state should detail why another waiver program is being used and which specific waiver(s) are used.

### ➤ Alternate Basis

- Specify the reasoning behind selecting the alternate basis not listed above. For example:
  - Pro-rated entrance into the waiver throughout the year, as may be the case in a de-institutionalization initiative.
  - ALOS based on the nature of the waiver and/or the individuals' specific condition, such as unusual illness.

# Appendix J-2-c: Derivation of Estimates

- Appendix J-2-c documents derivation of projections for each factor D, D', G and G'.
- States can trend each factor using inflation as the trend basis.
- Inflation basis used for trending should be identified in Appendix J-2-c.
- Commonly used inflation basis factors include:
  - In-State Trending Using 372(s) Report Analysis
  - Consumer Price Index (CPI)
  - Cost of Living Adjustment (COLA)

# In-State Trending Using 372(s) Report Analysis

- States report historical cost and utilization data for waiver services in 372 reports, which may be used as a basis to calculate rates and identify trends in rate increases.
- 372(s) reports, as discussed on Technical Guide page 276:
  - CMS expects the state to use this report as a basis for setting the factor D, D', G and G' for renewals and amendments, where applicable.
  - Use the most recent 3-5 years of historical cost and utilization data reported by the state in 372(s) reports to trend cost growth from year-to-year for the five-year projection.
  - State is still allowed to use another basis other than 372(s) but the departure should be “explained and justified”.

# Evaluating the Appropriateness of Using CMS-372(s) Data

- Using CMS-372(s) data may not be appropriate if:
  - There are outliers in the CMS-372(s) data (e.g., abnormally large increases and decreases in participant counts, service utilization, service costs etc.).
  - There are new services that are not reflected in CMS-372(s) data.
  - The waiver has undergone changes in the scope or definition of services.
  - There are external reasons for service cost or utilization changes. (e.g., addition of a specific number of slots or a legislative budgetary increase)

# Evaluating the Appropriateness of Using CMS-372(s) Data

- If states decide not to use CMS-372(s) data:
  - Detail the alternate basis used to estimate factors.
    - Example: Using service trends from similar waiver programs.
  - Explain why this approach was used.
    - Example: 372(s) data does not exist for a new service. However, a neighboring state has similar population demographics. They offer the same service under a waiver that also serves children with developmental and intellectual disabilities.

# Consumer Price Index (CPI)

- Measures changes in the price level of a market basket of consumer goods and services purchased by households over a given period of time.
- The CPI is a statistical estimate constructed using the periodically collected prices of a sample of representative items.
- If a state chooses CPI for trending basis, then the state should identify the type of CPI and month/year(s) used for basis.
  - States can access CPI data by going to the Bureau of Labor Statistics website (<http://www.bls.gov/cpi/>).
  - CPI can be further specified by state, city, or other specific geographical locations to get a more accurate picture of costs trends across geographic locations.
    - Types of CPI:
      - CPI-U: All urban consumers
      - CPI-W: Urban wage earners and clerical

# Cost of Living Adjustments (COLA)

- COLA is another type of inflation measure that is similar to and is most often based on CPI.
- If the state pays different rates based on geographical differences, the state should account for this variation in the final Factor D estimates.
  - For example, if cost of living is higher in one region of the state, the state can apply a COLA adjustment to pay a higher rate to providers in that region.
  - The state should analyze utilization differences between the two geographic regions and develop service estimates that combines both.

# Other Considerations for Factor D Estimation

- Appendix J-2-d-i or J-2-d-ii is used to demonstrate details of Factor D calculation.
  - Shows detailed elements that make up Factor D estimation.
- Describe the basis for calculating the elements used in Factor D estimation.
  - Estimated number of users
  - Units Per User
  - Average Cost per Unit
- This information should be consistent with Appendix C-1/C-3 and Appendix I-2-a.

# Factor D Example Demonstration: How to Calculate Estimated Number of Users Using CMS-372(s)\*

- **Step 1:** Collect historical data from the three most recent CMS-372(s) reports.

| Service        | Previous WY 3 Participants*<br>(A) | Previous WY 4 Participants*<br>(B) | Previous WY 5 Participants*<br>(C) |
|----------------|------------------------------------|------------------------------------|------------------------------------|
| Personal Care* | 100                                | 105                                | 109                                |

- **Step 2:** Calculate percentage change in the participant increase/decreases and determine the average trend.

| Service                                       | Waiver Year 3-4                      | Waiver Year 4-5                      |
|---|--------------------------------------|--------------------------------------|
|   | % Change Participants<br>$((B-A)/A)$ | % Change Participants<br>$((C-B)/B)$ |
| Personal Care*                                | 5.0%                                 | 3.8%                                 |
| <b>Average <math>((5.0\%+3.8\%)/2)</math></b> | <b>4.4%</b>                          |                                      |

\* All numbers and calculations are for demonstration purposes only.

# Factor D Example Demonstration: How to Calculate Estimated Number of Users Using CMS-372(s)\*

- **Step 3:** Apply the average trend of **4.4%** to estimate costs.
  - Start with the most recent 372(s) cost and continue until all costs are projected.

| Year           | Calculation                          | Estimated Participants for Personal Care* |
|----------------|--------------------------------------|---|
| Previous WY 5* | Actual Service Cost from CMS-372(s)* | 109                                       |
| WY 1           | $109 \times (1 + 0.044)$             | 114                                       |
| WY 2           | $114 \times (1 + 0.044)$             | 119                                       |
| WY 3           | $119 \times (1 + 0.044)$             | 124                                       |
| WY 4           | $124 \times (1 + 0.044)$             | 129                                       |
| WY 5           | $129 \times (1 + 0.044)$             | 135                                       |

\* All numbers and calculations are for demonstration purposes only.

# Summary

- Waiver factors comprising the cost neutrality formula allows the state to demonstrate that the cost of waiver program services is less than or equal to the cost of institutionalized programs for the same population.
- ALOS and unduplicated participants estimations should follow historical information and should have detailed explanations if figures deviate from the historical data.
- Derivation of estimates (Appendix J) should explain the basis of growth from year-to-year based on data from a reliable resource.
- Different inflation factors, such as CPI or COLA, can be used and must be fully justified when estimating rate increases.

# References

1. <http://www.bls.gov/opub/btn/volume-3/why-does-bls-provide-both-the-cpi-w-and-cpi-u.htm>
2. <http://www.bls.gov/cpi/cpifaq.htm>

# Additional Resources

- Additional rate setting resources are available in the below website. Topics include:
  - Rate Methodology in a FFS HCBS Structure
  - HCBS Rate Construction Illustration and Topical Discussion
  - Documentation of Rate Setting Methodology
  - Use of Inflation Factors
  - Data Validation
- <https://www.medicare.gov/medicaid-chip-program-information/by-topics/long-term-services-and-supports/home-and-community-based-services/hcbs-training.html>

# Questions

Additional questions can be sent to:

[HCBS@cms.hhs.gov](mailto:HCBS@cms.hhs.gov)