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March 11, 2004

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Via Fax and Mail

Jim Haynes
Vice President and Chief Financial Officer
Arizona Hospital and Healthcare Association
2901 N. Central Ave., Suite 900
Phoenix, AZ 85012

RE: Update to Cost Study for Hospitals with 25 or Fewer Beds

Dear Jim:

You contacted us to add more detail to the cost study report we provided on February 24, 2004. Initially you asked us to analyze 18 rural facilities currently being considered for financial assistance from the state of Arizona with an additional subset of hospitals with less than 75 beds. This report contains an additional subset of facilities with 25 or fewer beds.

As you know, the cost study was originally completed as part of our report provided to AHCCCS in November of 2002. The "Working Group" which included representation from both rural and urban hospitals as well as AHCCCS staff and AZHHA staff guided this work.

Important Caveats

Data Reliance

In the course of this engagement we have relied on data provided to us by AHCCCS, as well as data from Arizona hospitals who agreed to participate in these studies. We have performed no independent audit of the data we received. To the extent that the data we received is wrong, the results of our analyses will also be wrong.

Limitations on Distribution

Milliman USA understands that this report is intended for public distribution. Milliman does not intend to benefit and assumes no duty or liability to other parties who receive this work. Other parties may wish to consult with experts trained in actuarial and financial analysis when reviewing this report. Thus, the report should only be reviewed in its entirety. This report assumes that the reader is familiar with the Arizona Health Care Cost Containment System acute care programs – their eligibility, covered services,



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administration and other factors; hospital inpatient reimbursement methodologies and general statistical methods.

Summary of Results

The table below summarizes the results of the cost study. For this update like the previous version, only the costs allowed by Medicare were considered for the same reasons outlined in the prior report. The results are shown for facilities that have 25 or fewer beds, fewer than 75 beds, and a total for all facilities included in this study.

Table 1
Summary of Results – Cost Study
Ratio of AHCCCS Per Diem Payments to Cost
All Participating Hospitals Included

Cost Definition	Facilities	Cost Ratio	Range
< = 25 Beds	6	31%	24%-43%
< 75 Beds	15	52%	24%-63%
All Facilities	18	56%	24%-65%

The results of this table mean that on average for the 6 facilities with fewer than 25 beds, AHCCCS payments cover 31% of the estimated costs of providing care to AHCCCS patients. We also provide a range of results in the last column. This range should be interpreted as approximately 70% of the facilities in each category reflect cost coverage within the specified range.

For this study, DSH payments as well as payment for Critical Access Hospitals (CAH) are added to the AHCCCS payments. Table 2 shows similar results to Table 1 with the DSH and CAH added in.



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Table 2
Summary of Results – Cost Study
Ratio of AHCCCS Per Diem Payments to Cost
All Participating Hospitals Included
DSH and CAH included with AHCCCS Payments

Cost Definition	Facilities	Cost Ratio	Range
< = 25 Beds	6	52%	34%-78%
< 75 Beds	15	59%	38%-78%
All Facilities	18	62%	38%-78%

Enclosure 1 contains a more detailed summary of the values shown in Tables one and two.

If you have any questions about this report or enclosures, please give me a call at (480) 348-9020.

Sincerely,

Thomas D. Snook, F.S.A., M.A.A.A.
Principal & Consulting Actuary

TDS/pc

ENCLOSURE 1

ENCLOSURE 1

3/10/2004
1:04 PM

Arizona Health Care Cost Containment System

Cost Study

Threshold - 0.5%

Cap - 10.0

	No. of Facilities	Admits	ALOS	Days	Billed	AHCCCS Paid	DSH & CAH	Total AHCCCS Paid	Calculated Cost	Per Day		% of Cost Paid			
										AHCCCS Paid	AHCCCS + DSH Paid	Cost	Incl. DSH		
Rural <=25 Beds	6	1,127	2.44	2,755	3,802,547	2,503,978	1,717,779	4,221,757	8,096,462	1,380	909	1,532	2,939	31%	52%
Rural <75 Beds	15	8,735	2.41	21,013	36,135,376	20,896,139	2,727,486	23,623,625	40,285,608	1,720	994	1,124	1,917	52%	59%
Total	18	12,835	2.40	30,790	62,804,491	31,667,948	3,051,057	34,719,005	56,268,535	2,040	1,029	1,128	1,827	56%	62%

ENCLOSURE 2

ENCLOSURE 2

Arizona Health Care Cost Containment System Facilities Included in Cost Study

Benson Hospital
Cobre Valley Community Hospital
Copper Queen Community Hospital
Holy Cross Hospital - Nogales
La Paz Regional Hospital
Mount Graham Regional Medical Center
Navapache Regional Medical Center
Northern Cochise Community Hospital
Page Hospital
Payson Regional Medical Center
Sage Memorial Hospital
Sierra Vista Regional Health Center
Southeast Arizona Medical Center
Verde Valley Medical Center
Western Arizona Regional Medical Center
White Mountain Regional Medical Center
Wickenburg Regional Medical Center
Winslow Memorial Hospital