



Economic Impact Analysis Virginia Department of Planning and Budget

12 VAC 30-50; 141 –Amount, Duration, and Scope of Medical and Remedial Services, Amount, Duration, and Scope of Medical and Selected Services, and Family Access to Medical Insurance Security Plan

Department of Medical Assistance Services

March 23, 2006

Summary of the Proposed Regulation

The proposed regulations will increase the number of initial outpatient psychiatric visits for which no prior authorization required from 5 sessions during the first year to 26 sessions, making the prior authorization requirements less stringent. Additionally, the proposed changes will make several clarifications to the existing prior authorization requirements to avoid confusion.

Result of Analysis

The benefits likely exceed the costs for all proposed changes.

Estimated Economic Impact

The proposed regulations will make the prior authorization requirements for outpatient psychiatric visits less stringent. Currently, no prior authorization is required for the initial five sessions during the first year of the treatment. Starting with the sixth session, providers must obtain prior authorization from the Department of Medical Assistance Services (DMAS). With the proposed changes, providers will be able to provide up to 26 initial sessions during the first year of the treatment without having to obtain prior authorization from DMAS.

Prior authorization is a well known cost-containment mechanism. It increases the costs of providing care and provides incentives to refrain from unnecessary outpatient psychiatric treatment. The costlier is the prior authorization requirement, the stronger are the incentives not to over utilize. However, prior authorization mechanism also increases the costs of providing necessary care alike and may discourage the use of needed services. In addition, prior

authorization mechanism imposes significant administrative costs on DMAS just as it does on providers.

The fiscal effect of the proposed less stringent prior authorization requirements will be to reduce administrative expenses incurred by DMAS and by providers and to increase outpatient treatment expenditures as some of the services that would be denied under the current regulations would be paid under the proposed regulations. According to DMAS, in FY 2005, six full time employees were handling the prior authorization requests with combined annual salaries of approximately \$240,000. However, DMAS has plans in place to transfer the prior authorization function to a contractor. In fact, a contract is already signed assuming a prior authorization limit of 26 as proposed rather than five as currently exists. DMAS estimates that an additional \$350,000 would be required to adjust the prior authorization limit in the contract from 26 to five. This indicates that the administrative costs of the more stringent prior authorization program to DMAS are about \$350,000.

The fiscal effect of the proposed changes on outpatient treatment expenditures could be estimated by using denial rates and average cost per outpatient psychiatric claim. Before 2003, prior authorization was required after the 26th outpatient psychiatric session in the first year. In 2003, General Assembly mandated that prior authorization be obtained after the fifth session¹. Thus, in essence, the proposed changes will revert back the prior authorization requirements to those existed before 2003 providing an opportunity to estimate the potential impact on denial rates.

Based on the available data, in FY 2002 when prior authorization was required after the 26th session, the denial rate was very small (0.4%). In other words, almost all of the prior authorization applications were approved. In FY 2004, prior authorization was required starting with the sixth session rather than 27th. Under more stringent prior authorization requirements, the denial rate increased significantly to 4.3% of the requests. Moreover, in FY 2005, the denial rate almost doubled to 8.1% of the requests. In the first quarter of FY2006, the denial rate went down to 2.1%. Considering denied treatment requests would have been paid under the less stringent requirements, this data seems to suggest that the proposed changes would increase outpatient psychiatric treatment expenditures significantly. However, according to DMAS, due to reporting

¹ 2002-2004 Appropriation Act, Item 325 DDD(2).

changes and other factors such as managed care expansions, the changes in denial rates cannot be solely attributed to the change in prior authorization requirements and hence are not useful for estimating the fiscal impact of the proposed changes.

While the existing denial data is not reliable to estimate the fiscal impact on medical expenditures, in order to justify a \$350,000 increase in contract costs, the denial rate must decrease by 20.4% from their current level which is practically impossible². After carefully analyzing historical denial data, DMAS' best estimate for clinical necessity denials is about only 1.5% to 2%. Given this denial rate, the benefits of the proposed changes will significantly exceed the costs. For example, if the proposed less stringent prior authorization requirements reduce the denial rate to "0%" and the average cost per claim is about \$65, we could expect at the most about \$34,261 increase in outpatient treatment expenditures while the administrative savings would be about \$350,000. In addition, there will be administrative savings to providers. Thus, expected administrative savings to DMAS and the providers seem to greatly outweigh the expected increase in medical expenditures as a result of less claims being denied.

The expected net fiscal benefit from the proposed less stringent prior authorization requirements are likely to be offset to some degree by the adverse incentives it will provide to providers. Less stringent prior authorization requirements may weaken provider incentives not to over utilize outpatient psychiatric services and add to the medical expenditures. Even though the over utilization is possible, its magnitude is unlikely to be at a level that is sufficient to render the proposed changes cost ineffective.

The remaining proposed changes will clarify that MRAs and CTAs are subject to prior authorization requirements just as MRIs and CATs. When the prior authorization requirements for these diagnostic scans were adopted, the language did not specifically listed MRAs and CTAs as requiring prior authorization because DMAS never considered these tests being significantly different from MRIs and CATs. Upon realizing significant confusion among the providers, DMAS issued a memorandum in 2003 to clarify the intent of the regulation. Even though the confusion has been addressed by the 2003 memorandum, the proposed changes will clarify the regulatory language. Thus, no significant economic impact is expected from this

² Assuming 26,355 prior authorization requests per year, which is the average of requests received in FY 2004 and 2005 and \$65 for average claim costs.

particular proposed change other than reducing the likelihood of confusion among the providers who may be unaware of the 2003 memorandum.

Businesses and Entities Affected

The proposed outpatient psychiatric prior authorization requirements apply to approximately 600 psychiatrists, 1,104 clinical psychologists, 98 psychiatric clinical nurse specialists, 1,769 licensed clinical social workers, 1,117 licensed professional counselors, 12 marriage and family therapists, and 40 Community Service Boards. The other proposed changes apply to 98 hospitals, approximately, 4,150 radiologists, 152 independent labs. Also, the recipients utilizing services from all of these providers will be affected.

Localities Particularly Affected

The proposed regulations apply throughout the Commonwealth.

Projected Impact on Employment

Less stringent prior authorization requirements are expected to reduce the staffing needs of the contractor who will be administering this program and the providers as a result of lower number of prior authorization requests that will be initiated and decided. Thus, a reduction in demand for labor is expected.

Effects on the Use and Value of Private Property

The proposed regulations are expected to provide some administrative savings to the providers. Lower administrative savings should improve their profitability and contribute to asset values of their businesses.

Small Businesses: Costs and Other Effects

All of the affected entities except recipients, hospitals, and Community Service Boards could be considered as small businesses. As, discussed these small businesses are likely to see a reduction in administrative costs associated with the reduced number of prior authorizations that have to be secured before providing services.

Small Businesses: Alternative Method that Minimizes Adverse Impact

The proposed regulations are not anticipated to create an adverse impact on small businesses.

Legal Mandate

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.H of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.H requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. Further, if the proposed regulation has adverse effect on small businesses, Section 2.2-4007.H requires that such economic impact analyses include (i) an identification and estimate of the number of small businesses subject to the regulation; (ii) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the regulation, including the type of professional skills necessary for preparing required reports and other documents; (iii) a statement of the probable effect of the regulation on affected small businesses; and (iv) a description of any less intrusive or less costly alternative methods of achieving the purpose of the regulation. The analysis presented above represents DPB's best estimate of these economic impacts.