

**MEDICARE DRUG & HEALTH PLAN CONTRACT ADMINISTRATION GROUP**

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DATE: January 12, 2017

TO: Medicare Advantage Organizations  
Prescription Drug Plans  
Section 1876 Cost Plans  
Medicare-Medicaid Plans  
PACE Organizations

FROM: Kathryn A. Coleman  
Director

SUBJECT: Fiscal Soundness Requirements and Monitoring

This memorandum summarizes the potential actions the Centers for Medicare & Medicaid Services (CMS) may take to address organizations that are not meeting fiscal soundness requirements, including Medicare Advantage Organizations (MAOs), Medicare-Medicaid Plans (MMPs), Section 1876 Cost Plans (Cost Plans), Prescription Drug Plans (PDPs), and Programs of All-Inclusive Care for the Elderly (PACE) organizations.

CMS fiscal soundness requirements were clarified in the Health Plan Management System (HPMS) memorandum titled, "Clarification of Fiscal Soundness Requirements" issued on November 17, 2015. Organizations contracting with CMS are required to satisfy all applicable state licensure and state and CMS fiscal soundness requirements. These requirements help protect Medicare beneficiaries from potential harm and make sure that organizations contracting with CMS are financially viable.

CMS monitors an organization's compliance with fiscal soundness requirements, primarily through independently audited annual financial statements and other required documentation for the legal entity. CMS may also require additional information, such as business plans, financial projections with supporting assumptions, and quarterly financial statements for those organizations that are not already reporting on a quarterly basis to determine compliance with fiscal soundness requirements.

CMS has communicated or is currently in communications with several organizations that are not satisfying CMS fiscal soundness requirements. To the extent possible, we will provide flexibilities to those organizations in a way that will align our previous approach with the process outlined below.

## **Medicare Advantage Organizations, Prescription Drug Plan Sponsors, and Medicare-Medicaid Plans**

The specific conditions identified below will result in a “Does Not Meet” fiscal soundness review:

### Evaluation Criteria:

1. A negative net worth (liabilities greater than assets), and/or
2. A negative net income (net loss) which is greater than one-half of the entity’s total net worth.

**CMS Actions:** An organization receiving a “Does Not Meet” for either Criterion #1 (negative net worth) or Criterion #2 (net loss which is greater than one-half of the entity’s total net worth) will be required to submit quarterly financial statements and will be monitored closely by CMS.\*

Additionally, an organization receiving a “Does Not Meet” for Criterion #1 (negative net worth) following the receipt of audited annual financial statements will result in a compliance action. CMS will generally increase the severity of the compliance action following the escalation process outlined below for organizations that continue to demonstrate a negative net worth on subsequent audited annual financial statements.

1. Notice of Non-Compliance
2. Warning Letter
3. Warning Letter with Business Plan
4. Corrective Action Plan (CAP)

In situations where there are very serious concerns about an organization’s financial solvency, CMS may advance to a more severe compliance action or move to terminate organizations pursuant to 42 C.F.R. §422.510 and §423.509 that continue to receive a “Does Not Meet” for Criterion #1. Organizations are also subject to negative past performance points for Criterion #1 on an annual basis for failure to maintain fiscally sound operations (see the Application Cycle Past Performance Review Methodology issued annually by CMS).

\*New organizations and PDPs report on a quarterly basis regardless of fiscal soundness review status.

## **Section 1876 Cost Plans**

The specific conditions identified below will result in a “Does Not Meet” fiscal soundness review:

### Evaluation Criteria:

1. A negative net worth (unsubordinated liabilities greater than assets), and/or

2. A negative net income (net loss) which is greater than one-half of the entity's total net worth.

CMS Actions: A Cost Plan receiving a “Does Not Meet” for either Criterion #1 (negative net worth) or Criterion #2 (net loss which is greater than one-half of the entity's total net worth) will be required to submit quarterly financial statements and will be monitored closely by CMS.

Additionally, a Cost Plan receiving a “Does Not Meet” for Criterion #1 (negative net worth) following the receipt of audited annual financial statements will result in a compliance action. CMS will generally increase the severity of the compliance action following the escalation process outlined below for organizations that continue to demonstrate a negative net worth on subsequent audited annual financial statements.

1. Notice of Non-Compliance
2. Warning Letter
3. Warning Letter with Business Plan
4. Corrective Action Plan (CAP)

In situations where there are very serious concerns about an organization's financial solvency, CMS may advance to a more severe compliance action or move to terminate organizations pursuant to 42 C.F.R. §417.494 and §423.509 that continue to receive a “Does Not Meet” for Criterion #1. Cost Plans are also subject to negative past performance points for Criterion #1 on an annual basis for failure to maintain fiscally sound operations (see the Application Cycle Past Performance Review Methodology issued annually by CMS).

### **PACE Organizations**

The specific conditions identified below will result in a “Does Not Meet” fiscal soundness review:

#### Evaluation Criteria:

1. A negative net worth (unsubordinated liabilities greater than assets), and/or
2. A negative net income (net loss) which is greater than one-half of the entity's total net worth.

CMS Actions: A PACE organization receiving a “Does Not Meet” for either Criterion #1 (negative net worth) or Criterion #2 (net loss which is greater than one-half of the entity's total net worth) will be required to submit quarterly financial statements and will be monitored closely by CMS.\*\*

Additionally, a PACE organization receiving a “Does Not Meet” for Criterion #1 (negative net worth) following the receipt of audited annual financial statements for the year prior to the trial period end date will result in CMS issuing a technical assistance letter. For purposes of fiscal soundness, the trial period ends when CMS has reviewed independently audited annual financial statements covering three full 12-month financial reporting periods.

A PACE organization receiving a “Does Not Meet” for Criterion #1 (negative net worth) following the receipt of audited annual financial statements due on or after the trial period end date will result in a compliance action. CMS will generally increase the severity of the compliance action following the escalation process outlined below for organizations that continue to demonstrate a negative net worth on subsequent audited annual financial statements.

1. Notice of Non-Compliance
2. Warning Letter
3. Warning Letter with Business Plan
4. Corrective Action Plan (CAP)

In situations where there are very serious concerns about an organization’s financial solvency, CMS may advance to a more severe compliance action or move to terminate organizations pursuant to 42 C.F.R. §460.50 that continue to receive a “Does Not Meet” for Criterion #1. CMS past performance requirements do not currently apply to PACE organizations.

**\*\*PACE organizations in the trial period report on a quarterly basis regardless of fiscal soundness review status.**

### **Unsubordinated Liabilities Calculation (Section 1876 Cost Plans and PACE)**

CMS calculates the net worth of PACE organizations and Cost Plans by subtracting total unsubordinated liabilities from total assets, as reported on the balance sheet for the legal entity. Beginning with the contract year 2017 release of the Fiscal Soundness Reporting Requirements and HPMS fiscal soundness module (March 2017), CMS will consider subordinated and guaranteed debt when calculating total unsubordinated liabilities.

Subordinated debt is defined as an unsecured debt whose repayment to its parent organization ranks after all other debts have been paid when the subsidiary files for bankruptcy. An example of subordinated debt is when the parent organization loans money to the PACE organization or Cost Plan to pay its debts. The PACE organization or Cost Plan only needs to repay the parent organization after all of its other liabilities have been satisfied.

Guaranteed debt is defined as secured debt in which another entity promises to pay a loan or other debt if the organization that borrowed the money fails to pay. An example of guaranteed debt is when the PACE organization or Cost Plan obtains a loan from a bank and another entity signs on to guarantee payment of all, or a portion of, the loan. In the event of bankruptcy or default, the other entity will make payments on the loan on behalf of the PACE organization or Cost Plan to ensure the debt is satisfied.

PACE organizations and Cost Plans must identify the subordinated and/or guaranteed debt portion of their reported total liabilities and submit the updated “Subordinated/Guaranteed Debt Attestation Form” available in the fiscal soundness module within HPMS with both quarterly (if applicable) and audited annual financial statements. In addition, organizations reporting guaranteed debt must submit in conjunction with their audited annual financial statements, the

opinion of an independent auditor certifying the amount of guaranteed debt and that there are no repayment requirements by the PACE organization or Cost Plan in the event of default. CMS will not consider guaranteed debt when calculating unsubordinated liabilities in the absence of the completed “Subordinated/Guaranteed Debt Attestation Form” and the opinion of an independent auditor.

For questions concerning this memo please contact the Financial Review mailbox at [FinancialReview@cms.hhs.gov](mailto:FinancialReview@cms.hhs.gov).