DEPARTMENT OF HEALTH & HUMAN SERVICES
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CMS
CENTERS FOR MEDICARE & MEDICAID SERVICES
CENTER FOR MEDICARE

MEDICARE DRUG & HEALTH PLAN CONTRACT ADMINISTRATION GROUP

DATE: November 17, 2015

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

FROM: Kathryn A. Coleman
Director

SUBJECT: Clarification of Fiscal Soundness Requirements

The purpose of this memorandum is to clarify fiscal soundness requirements for Medicare Advantage Organizations (MAOs), Medicare-Medicaid plans (MMPs), Programs of All Inclusive Care for the Elderly (PACE) organizations, 1876 Cost Plans, and Prescription Drug Plans (PDPs) that contract with the Centers for Medicare & Medicaid Services (CMS). These organizations are required to satisfy all applicable state licensure, state and CMS financial requirements, and to submit their independently audited financial statements to CMS on an annual basis.

CMS contracts with legal entities whose financial statements are evaluated on their own merit. If the Domestic State permits organizations to submit financial statements that include other lines of business with the legal entity, CMS will accept these financial statements. However, the organization's resources included in the financial statements submitted, must support and back the line of business contracted with CMS.

In March of each year CMS announces the release of the current year's Fiscal Soundness Module (FSM), which is part of the Health Plan Management System (HPMS), along with the Fiscal Soundness Reporting Requirements (FSRR). Instructions for existing and new organizations are provided in the FSRR located at http://www.cms.gov/Medicare/Health-Plans/HealthPlansGenInfo/FSRR.html.

Requirements

MAOs, PDPs, and Medicare-Medicaid Plans
Pursuant to 42 C.F.R. §§422.504 and 423.505 organizations must maintain a fiscally sound operation and must provide CMS audited annual financial statements demonstrating a fiscally sound operation. Audited annual financial statements must be prepared in accordance with generally accepted accounting principles (unless the Domestic State requires otherwise) and are

due to CMS within 120 days of the end of its fiscal year, unless an extension has been granted by CMS.

In order to maintain a fiscally sound operation the organization must, at a minimum, maintain a positive net worth (total assets exceed total liabilities).

<u>1876 Cost Plans</u>

Pursuant to 42 C.F.R. §§417.120 and 417.126 Cost plans must maintain a fiscally sound operation. Audited annual financial statements must be prepared in accordance with generally accepted accounting principles (unless the Domestic State requires otherwise) and are due to CMS within 120 days of the end of its fiscal year, unless an extension has been granted by CMS.

In order to maintain a fiscally sound operation the organization must demonstrate:

1. Total assets greater than total unsubordinated liabilities;
2. Sufficient cash flow and adequate liquidity to meet obligations as they become due;
3. A net operating surplus; and,
4. An insolvency protection plan for the protection of enrollees.

<u>PACE Organizations</u>

Pursuant to 42 C.F.R. §§460.80 and 460.208 PACE organizations must maintain a fiscally sound operation and must provide CMS audited annual financial statements demonstrating a fiscally sound operation. Audited annual financial statements must be prepared in accordance with generally accepted accounting principles (unless the Domestic State requires otherwise) and are due no later than 180 days after the organization's fiscal year ends. PACE organizations operating within their trial period (3 years) must also submit quarterly financial statements. 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.

In order to maintain a fiscally sound operation the PACE organization must, at a minimum, maintain:

1. Total assets greater than total unsubordinated liabilities;
2. Sufficient cash flow and adequate liquidity to meet obligations as they become due; and,
3. A net operating surplus or a financial plan for maintaining solvency that is satisfactory to CMS and the State Administering agency

As stated in the HPMS memo titled, "Attestation of Subordinated Debt Arrangements" issued August 11, 2011 and clarified in this memo, CMS contracts with the PACE legal entity. Therefore, all fiscal soundness requirements must be met by the individual PACE legal entity, not the parent organization, and any substitutions are unallowable. If the PACE organization is a line of business of the parent organization, and audited annual financial statements are not available at the PACE legal entity level, audited annual financial statements may be provided for the parent organization. However, the PACE organization must report the required financial data elements: Assets, Liabilities, Subordinated Debt (if applicable), Net Income/Loss, and Cash Flow from Operations and provide supporting annual financial statements for the corresponding period at the PACE legal entity level.

Total unsubordinated liabilities are used to determine a PACE organization's net worth. PACE organizations must identify the subordinated debt portion of their reported total liabilities. CMS will calculate total unsubordinated liabilities by subtracting subordinated debt from total liabilities prior to making the final fiscal soundness determination.

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. PACE organizations that report subordinated debt with a parent organization must complete a subordinated debt arrangement attestation form and upload a signed version into the Health Plan Management System (HPMS) Fiscal Soundness Module (FSM) with all annual and quarterly financial statements submissions. The PACE Organization Attestation of Subordinated Debt Arrangement form can be located under the documentation section of the FSM in HPMS.

Compliance

Organizations are also subject to compliance notices and/or past performance points for failure to meet fiscal soundness requirements (see HPMS Memo titled "2016 Application Cycle Past Performance Review Methodology Final" issued February 11, 2015). PACE organizations are not subject to past performance points at this time. If an organization's financial status does not improve following a compliance notice, CMS may issue additional notices or increase the severity of the notice.

Below are specific conditions that will result in a "Does Not Meet" fiscal soundness review that may result in a compliance action. For organizations that find themselves possessing both a negative net worth (liabilities greater than assets) and a negative net income (net loss), CMS may increase the severity of the notice.

<u>MAOs, PDPs, and Medicare-Medicaid Plans</u>

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.

<u>1876 Cost Plans</u>

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.

<u>PACE Organizations</u>

1. A negative net worth (unsubordinated liabilities greater than assets). CMS will provide technical assistance to PACE organizations failing to meet fiscal soundness requirements, specifically, negative net worth. PACE organizations must ensure financial statements and financial information is submitted at the appropriate organizational level and any subordinated debt arrangements with the parent organization are properly reported to CMS. Following a reasonable period of technical assistance, CMS may take further action including compliance notices to ensure PACE organizations comply with fiscal soundness requirements.

Note: PACE organizations that report a negative net income (net loss) which is greater than one-half of the entity's total net worth will continue to receive a "Does Not Meet" fiscal soundness review and CMS will continue to monitor on a quarterly basis.

For questions concerning this memo please contact the Financial Review mailbox at **FinancialReview@cms.hhs.gov.**