

May 21, 2018

Jeff Butcher
Chief Financial Officer
Health Choice Arizona
410 N. 44th St. Suite 900
Phoenix, Arizona 85008

Subject: Compliance Action - Notice of Sanction

Dear Mr. Butcher:

The Arizona Health Care Cost Containment System (AHCCCS), Division of Health Care Management (DHCM) has determined that Health Choice Arizona (HCA) is in violation of contract YH14-0001 for acute care services as outlined in Section D, Paragraph 71 (Sanctions) of the Acute Care Contract:

In accordance with applicable Federal and State regulations, A.A.C. R9-22-606, ACOM Policy 408, ACOM Policy 440, Section 1932 of the Social Security Act or any implementing regulation, and the terms of this Contract, AHCCCS may impose sanctions for failure to comply with any provision of this Contract...

AHCCCS is imposing a regulatory action as HCA has failed to demonstrate compliance with the contractual requirement that any equity distribution requires prior approval from AHCCCS. Paragraph 48, page 121 of the contract reads in part as follows:

The Contractor shall not, without the prior approval of AHCCCS, make any advances, equity distributions, loans, loan guarantees, or investments, including, but not limited to those to related parties or affiliates including another fund or line of business within its organization. The Contractor shall not, without prior approval of AHCCCS, make loans or advances to providers in excess of \$50,000. All requests for prior approval are to be submitted to the AHCCCS, Division of Health Care Management, as specified in Section F, Attachment F3, Contractor Chart of Deliverables. Refer to ACOM Policy 418 for further information.

Background:

HCA failed to request prior approval or disclose an equity distribution made on September 28, 2017 in conjunction with the merger of IASIS with Steward Healthcare. AHCCCS discovered that a very large equity distribution had occurred through the review of the HCA September 30, 2017 draft audited financial statements. The reduced equity reported in the first submission of the draft audited financial statements, resulting from the equity distribution recorded, caused HCA to be out of compliance with the equity per member requirement. AHCCCS notified HCA of this issue, and HCA resubmitted modified draft audited financial statements resulting from a smaller equity distribution that maintained HCA's compliance with the equity per member requirement. Below is a table showing the impact of the equity distribution to the parent company, IASIS, which took place on September 28, the day before the merger with Steward.

Total equity prior to distribution	319,270,610.58
Change in retained earnings due to distribution	<u>(289,480,000.58)</u>
Total remaining equity	29,790,610.00

% change in equity due to distribution **-90.7%**

Additionally, in accordance with ACOM Policy 317, IASIS provided to AHCCCS post-merger pro-forma financial statements on June 9, 2017 for consideration of approval for the merger. HCA failed to identify that a material change to the equity balances would be occurring with the merger.

Regulatory Action:

HCA is subject to sanction for failing to request prior approval of an equity distribution. Because of the egregious nature of the action:

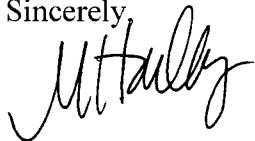
- (1) failure to request the transfer,
- (2) discovered by AHCCCS independently,
- (3) the reported transfer left HCA out of compliance with the financial viability requirement, and
- (4) non-disclosure of the distribution in the pro-forma merger financial statements,

AHCCCS will impose a monetary sanction in the amount of **\$125,000**. The total sanction amount will be withheld from future capitation payments.

If HCA disagrees with this decision, the Contractor may file a dispute with the AHCCCS Administration using the process outlined in A.A.C. R9-34-401 et. seq. The dispute must be filed in writing and must be received by the AHCCCS Administration, Office of Administrative Legal Services at 701 E. Jefferson Street, Phoenix, Arizona 85034, no later than 60 days from the date of this letter. The dispute shall specify the legal and factual bases for the dispute as well as the relief requested.

If HCA has any questions regarding this letter you may contact Shelli Silver at (602) 417-4647 or Shelli.Silver@azahcccs.gov.

Sincerely,



Meggan Harley, CPPO, MSW
Chief Procurement Officer

Cc: Shawn Nau, HCA
Nicole Larson, HCA
Shelli Silver, AHCCCS
Cynthia Layne, AHCCCS
Pamela Sullivan, AHCCCS
Virginia Rountree, AHCCCS
Christina Quast, AHCCCS
Scott Jewart, AHCCCS