SOUTHWEST CATHOLIC
HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION

Years Ended June 30, 2015 and 2014

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION

Years Ended June 30, 2015 and 2014

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

We have audited the accompanying consolidated financial statements of ***Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate***, which comprise the consolidated statements of financial position as of June 30, 2015 and 2014, and the related consolidated statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate*** as of June 30, 2015 and 2014, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mayer Hoffman McCann P.C.

Phoenix, Arizona
October 26, 2015

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2015 and 2014
(In thousands)

ASSETS

	2015	2014
CURRENT ASSETS		
Cash and cash equivalents	$ 251,676	$ 143,567
Short-term investments	19,288	17,101
Receivables:		
Reinsurance receivables, net of allowance for doubtful accounts of $7,069 for 2015 and $4,692 for 2014	19,290	17,338
Reconciliation receivables	11,809	19,780
Capitation and supplemental receivables	8,824	69,668
Pharmacy rebate receivables	12,172	6,624
Third-party liability receivable, net of allowance for doubtful accounts of $1,517 for 2015 and $958 for 2014	3,176	4,628
Interest receivable	321	655
Provider advances, net of allowance for doubtful accounts of $1,086 for 2015 and $1,566 for 2014	6,602	4,647
Other receivables	359	375
Risk share settlement	15,119	7,288
Due from ADHS	12,967	1,128
Due from Aetna	10,461	-
Prepaid assets	1,824	1,550
Due from District	-	5,000
TOTAL CURRENT ASSETS	373,888	299,349
RESTRICTED SECURITIES	520	521
CAPITALIZED SOFTWARE COSTS, net	2,884	3,653
RISK SHARE SETTLEMENT, less current portion	2,331	4,061
LONG-TERM INVESTMENTS	105,968	104,568
TOTAL ASSETS	$ 485,591	$ 412,152

LIABILITIES AND NET ASSETS

	2015	2014
CURRENT LIABILITIES		
Medical claims payable	$ 242,694	$ 200,508
Payable to providers	5,973	2,966
Reconciliation payable	29,937	7,170
Due to ADHS	117	707
Due to Aetna	-	7,005
Deferred revenue	225	-
Other current liabilities	11,141	6,873
TOTAL CURRENT LIABILITIES	290,087	225,229
RISK SHARE SETTLEMENT PAYABLE	2,629	-
DUE TO DISTRICT	12,860	8,885
TOTAL LIABILITIES	305,576	234,114
UNRESTRICTED NET ASSETS	180,015	178,038
TOTAL LIABILITIES AND NET ASSETS	$ 485,591	$ 412,152

See Notes to Consolidated Financial Statements

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2015 and 2014
(In thousands)

	2015	2014
OPERATING REVENUES		
Capitation premiums	$ 2,945,105	$ 1,941,643
Delivery supplement	59,020	60,073
Reinsurance	53,020	50,262
Other, primarily third party recoveries	1,936	2,864
TOTAL OPERATING REVENUES	3,059,081	2,054,842
HEALTH CARE EXPENSES		
Hospitalization	331,576	297,088
Medical compensation	313,902	296,455
Ancillary and other medical services	1,770,624	909,243
Institutional	189,689	178,003
Home and community based services	173,772	161,882
TOTAL HEALTH CARE EXPENSES	2,779,563	1,842,671
GENERAL AND ADMINISTRATIVE EXPENSES	213,433	160,172
PREMIUM TAX EXPENSE	33,500	27,228
TOTAL EXPENSES	3,026,496	2,030,071
OPERATING INCOME	32,585	24,771
NONOPERATING INCOME (EXPENSE)		
Investment income	7,615	17,405
Investment fees	(570)	(1,035)
TOTAL NONOPERATING INCOME	7,045	16,370
CHANGE IN NET ASSETS PRIOR TO UNREALIZED LOSSES ON INVESTMENTS	39,630	41,141
UNREALIZED LOSSES ON INVESTMENTS	(3,762)	(1,451)
CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS AND CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	35,868	39,690
DISTRIBUTIONS TO SPONSOR ORGANIZATIONS	(30,000)	(40,000)
CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	(3,891)	783
CHANGE IN NET ASSETS	1,977	473
NET ASSETS, BEGINNING OF YEAR	178,038	177,565
NET ASSETS, END OF YEAR	$ 180,015	$ 178,038

See Notes to Consolidated Financial Statements

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended June 30, 2015 and 2014
(In thousands)

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets prior to distributions and change in net assets attributable to District	$ 35,868	$ 39,690
Adjustments to reconcile change in net assets prior to distributions and change in net assets attributable to District to net cash provided by operating activities:		
Bad debt expense	7,500	8,346
Amortization expense	769	192
Net unrealized losses on investments	3,761	1,452
Net unrealized losses (gains) on restricted securities	1	(1)
Net realized gains on investments	(5,406)	(13,905)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Reinsurance receivables	(7,491)	6,783
Reconciliation receivables	7,971	(3,289)
Capitation and supplemental receivables	60,737	(61,901)
Pharmacy receivable	(5,548)	(1,959)
Third party liability receivable	(66)	815
Interest receivable	334	238
Provider advances	(2,291)	3,391
Other receivables	16	(744)
Risk share settlement	(3,472)	137
Due from ADHS	(11,839)	-
Due from Aetna	(10,461)	-
Prepaid assets	(274)	(1,418)
Increase (decrease) in:		
Medical claims payable	42,186	43,231
Payable to providers	3,007	2,966
Reconciliation payable	22,767	(9,940)
Due to ADHS	(590)	707
Due to Aetna	(4,291)	1,602
Deferred revenue	225	-
Other current liabilities	4,268	(2,342)
Due to District	84	(83)
Net cash provided by operating activities	137,765	13,968
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of restricted securities	-	500
Purchase of restricted securities	-	(520)
Capitalized software costs	-	(3,083)
Purchases of investments	(73,390)	(86,866)
Proceeds from sale of investments	71,448	149,059
Net cash provided by (used in) investing activities	(1,942)	59,090
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from Aetna for Mercy Maricopa start-up costs	-	14,226
Payments to Aetna for Mercy Maricopa start up costs	(2,714)	(11,889)
Collection on amounts due from District	5,000	-
Distributions to sponsor organizations	(30,000)	(40,000)
Net cash used in financing activities	(27,714)	(37,663)
NET CHANGE IN CASH AND CASH EQUIVALENTS	108,109	35,395
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	143,567	108,172
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 251,676	$ 143,567

See Notes to Consolidated Financial Statements

(1) Company operations and significant accounting policies

Company operations - Southwest Catholic Health Network Corporation dba Mercy Care Plan (SCHN, or the Plan) is a nonprofit corporation, whose sponsor organizations are Dignity Health (Dignity) and Carondelet Health Network (Carondelet), collectively the "sponsors." SCHN provides medical care under various contracts with the Arizona Health Care Cost Containment System (AHCCCS), a department of the state of Arizona charged with administering health care for the state's indigent population. SCHN provides medical coverage under the AHCCCS contract for the following populations:

- AHCCCS Acute - Members eligible under Title XIX Medicaid program and Title XXI program requirements
- Arizona Long Term Care System (ALTCS) - Provide institutional care, home and community based services and behavioral health services to the long term care members
- Arizona Department of Economic Security, Division of Developmental Disabilities (DES/DDD) - provide medical services to eligible members
- AHCCCS Healthcare Group (HCG) – Provide coverage primarily to small businesses. Program was terminated December 31, 2013.

Effective January 22, 2013, Mercy Maricopa Integrated Care (Mercy Maricopa), was incorporated in the State of Arizona with a dissolution date of the later of December 31, 2021 or six months after the expiration of the Regional Behavioral Health Authority (RBHA) contract. The initial members of Mercy Maricopa are SCHN, its two sponsor organizations Dignity and Carondelet, and Maricopa County Special Health Care District (District). The by-laws provide that Mercy Maricopa shall have one class of members initially; however, the current members may decide to create additional classes of membership or to add new members with unanimous consent of existing members. Relative interests of the members of Mercy Maricopa and the formula for distributions to members effective September 9, 2013 is as follows:

SCHN	85%
District	15%

The agreements also provide that SCHN serve as the managing member of Mercy Maricopa.

Mercy Maricopa was formed to provide physical and behavioral health care services on an integrated basis to Medicaid eligible adults with serious mental illness, and to operate as the RBHA to coordinate the delivery of health care services to eligible persons in Maricopa County, Arizona. Mercy Maricopa was initially funded through a $30 million capital contribution from SCHN and a $10 million capital contribution from District. SCHN contributed additional capital totaling $25 million during each of the years ended June 30, 2015 and 2014. For financial reporting purposes, Mercy Maricopa is consolidated with SCHN due to control through means of the membership agreement.

On March 25, 2013, Mercy Maricopa was awarded a $3 billion three year contract with the Arizona Department of Health Services (ADHS) to serve as the designated RBHA for the geographical service area (GSA) of Maricopa County. This new contract was to take effect October 1, 2013; however, the prior contract holder filed a legal challenge and requested and received a stay order requiring the contract to remain with the prior contract holder until the legal challenge had been decided. On December 3, 2013, the Deputy Director of the Arizona Department of Administration issued an Order affirming the Arizona Department of Health Services award of the GSA 6 Integrated Care RBHA contract to Mercy Maricopa effective April 1, 2014. The contract expires September 30, 2016 and has two optional one year extensions.

Mercy Maricopa is responsible for managing and maintaining an organized, comprehensive integrated healthcare delivery system for the benefit of eligible members within its assigned geographical service area.

(1) Company operations and significant accounting policies (continued)

SCHN and Mercy Maricopa operate Medicare Advantage Plans (Medicare Advantage) with the Centers for Medicare and Medicaid Services (CMS), offering medical and prescription drug benefits to qualified members. Medicare Advantage operates as a special needs plan under CMS guidelines. The populations covered under Medicare Advantage are members who are eligible for both Medicare and Medicaid coverage.

SCHN has had a management agreement with Aetna since 2007, which is a continuation of the agreement held with Schaller Anderson, L.L.C. since 2001. The current agreement is ongoing and a new contract is being developed. Mercy Maricopa entered into a five year management agreement with Aetna effective May 1, 2013. The Mercy Maricopa agreement automatically renews for a second 5 year term and thereafter for successive one-year periods. Under the terms of the agreements, SCHN and Mercy Maricopa pay a monthly fee to Aetna, as defined in the agreement, to cover the employee salary and benefit costs and general and administrative expenses incurred to operate the organizations. SCHN and Mercy Maricopa incurred management fees per the management agreements of approximately $218,188,000 for the year ended June 30, 2015, and $143,388,000 for the year ended June 30, 2014. These amounts are included in general and administrative expenses in the accompanying consolidated statements of activities and changes in net assets. At June 30, 2015 unpaid management fees due to Aetna totaled approximately $198,000 and are included in Due from Aetna in the accompanying consolidated statements of financial position. At June 30, 2014, unpaid management fees due to Aetna totaled approximately $1,256,000 and are included in Due to Aetna in the accompanying consolidated statements of financial position.

Concurrent with the management agreement, Mercy Maricopa executed a letter of agreement that remained in effect until the one year anniversary of the start date of the ADHS contract (April 1, 2014). Under the terms of the letter of agreement, Aetna assumed the costs incurred by Mercy Maricopa in pursuit of any protest filed in connection with the ADHS contract and any defense thereof. In addition, Aetna paid for certain implementation costs, as defined in the letter of agreement, to cover employee salary and benefit costs and general and administrative expense incurred as start-up expenses. Upon termination of the letter of agreement, Mercy Maricopa reimbursed Aetna an amount equal to the lesser of the implementation costs incurred or $20,000,000. For the year ended June 30, 2014, Aetna paid implementation costs totaling approximately $14,226,000. In fiscal 2015, upon a full reconciliation of implementation costs, Aetna reduced the amount due from Mercy Maricopa by approximately $1,583,000 of previously billed implementation costs. Total amounts repaid to Aetna in accordance with the agreement for implementation costs totaled approximately $2,714,000 and $11,889,000 for the years ended June 30, 2015 and 2014, respectively. Amounts due to Aetna for implementation costs totaled $0 and $4,297,000 at June 30, 2015 and 2014, respectively and are included in Due to Aetna in the accompanying consolidated statements of financial position.

SCHN's management agreement provides for a share of risk of the results of operations. Subject to certain performance measures, amounts will either be due from or due to Aetna. Additionally, the management agreement provides for supplemental compensation to be paid to Aetna upon meeting certain performance measures. At June 30, 2015 net amounts due from Aetna totaled approximately $10,000,000 and at June 30, 2014 net amounts due to Aetna were approximately $2,000,000, relating to these provisions in the management agreement. Mercy Maricopa's agreement does not provide for a share of the risk of the results from operations.

The significant accounting policies followed by SCHN and Mercy Maricopa, collectively referred to in these consolidated financial statements as the "Company", are summarized below:

(1) Company operations and significant accounting policies (continued)

Consolidation policy - The consolidated financial statements include the accounts of SCHN and Mercy Maricopa. The Company reports non-controlling interests in consolidated entities as a component of the Due to District, separate from the Company's net assets. For purposes of consolidation, all significant inter-company balances and transactions have been eliminated in consolidation.

Basis of presentation - The accompanying consolidated financial statements have been prepared in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 954-205, *Health Care Entities – Presentation of Financial Statements*. The Company's consolidated financial statements are also presented in accordance with FASB ASC 958-205, *Not-for-Profit Entities – Presentation of Financial Statements.* Under FASB ASC 958-205, the Company is required to report information regarding its consolidated financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. As of June 30, 2015 and 2014, there were no temporarily restricted or permanently restricted net assets.

Management's use of estimates - The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents - Cash includes cash deposits in banks and cash equivalents. The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Amounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC).

Capitation premiums - The Plan receives from AHCCCS, DES/DDD and CMS fixed capitation payments, generally in advance, based on certain rates for each member enrolled with the Plan. The Plan is required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the Plan retains the funds as profit; if the costs are higher than the amount of capitation payments, the Plan absorbs the loss. Capitation premiums are recognized in the month that enrollees are entitled to health care services. Certain provisions of the AHCCCS Acute, DDD and ALTCS contracts include a risk band whereby SCHN and the AHCCCS programs share in the profits and losses of the contract, as defined in the respective contracts (reconciliation revenue). SCHN has recorded an estimate of the reconciliation revenue, within capitation premiums, based on the operational performance of the AHCCCS Acute, DDD and ALTCS lines of business. The Plan may recover certain losses for those cases eligible for reinsurance payments.

Capitation is paid prospectively as well as for prior period coverage (PPC) under the AHCCCS Acute and ALTCS contracts. The PPC period is the period of time prior to the member's enrollment, during which a member is eligible for covered services. The timeframe is from the effective date of eligibility to the day a member is enrolled with a Contractor. The risk under PPC is shared by both the Plan and AHCCCS for the contract years ended September 30, 2015 and 2014. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the contract year.

(1) Company operations and significant accounting policies (continued)

The Plan shares risk with AHCCCS and DES/DDD for specific populations as follows:

- Acute Prospective
- Acute Prior Period Coverage
- Adult Group above 106% Federal Poverty Level (formerly known as the Newly Eligible Adults Prospective and Prior Period Coverage (effective January 1, 2014))
- ALTCS Prior Period Coverage
- Home and Community Based Services
- Share of Cost

Profits in excess of the percentages set forth by the contract will be recouped by AHCCCS. Losses in excess of the percentages set forth by the contract will be paid to the contractor. As of June 30, 2015, the Company has recorded an estimated receivable of approximately $11,809,000 due from AHCCCS and an estimated payable of approximately $29,937,000 due to AHCCCS which is included in reconciliation receivables and reconciliation payable, respectively. Additionally, as of June 30, 2014, the Company has recorded an estimated receivable of approximately $19,780,000 due from AHCCCS and an estimated payable of approximately $7,170,000 due to AHCCCS which is included in reconciliation receivables and reconciliation payable, respectively. Reconciliation receivable and payable amounts pertaining to separate contracting agencies cannot be offset against reconciliation receivable and payable balances of a different contracting agency, and as such, amounts have been presented separately as a payable and receivable balance on the accompanying consolidated statements of financial position.

The Patient Protection and Affordable Care Act (ACA) requires that Contractors pay qualified primary care providers (and other providers specified in ACA) fees that are no less than the Medicare fee schedule in effect for 2013 and 2014, or the fee schedule rate that would result from applying the 2009 Medicare conversion factor, whichever is greater, for certain services designated by specific Current Procedural Terminology (CPT) codes. AHCCCS has developed an enhanced fee schedule containing the qualifying codes using the 2009 Medicare conversion factor in compliance with the greater-of requirement. The enhanced payments apply only to services provided on and after January 1, 2013 through December 31, 2014 by qualified providers, who self-attest to AHCCCS as defined in the federal regulations.

The Plan was required to reprocess all qualifying claims for qualifying providers back to January 1, 2013 dates of service with no requirements that providers re-submit claims or initiate any action. In the event that a provider retroactively loses his/her qualification for enhanced payments, the Contractor was required to identify impacted claims and automatically reprocess for the recoupment of enhanced payments. This reprocessing was be conducted by the Contractor without requirement of further action by the provider.

AHCCCS will make quarterly cost-settlement payments to the Contractor based upon adjudicated/approved encounter data. The Contractor will be required to refund payments to AHCCCS for any reduced claim payments in the event that a provider is subsequently “decertified” for enhanced payments due to audit or other reasons. For the years ended June 30, 2015 and 2014, approximately $18,223,000 and $29,813,000 was earned from AHCCCS for these cost-settlement payments based upon adjudicated/approved encounter data, which is included in capitation premiums on the accompanying consolidated statements of activities and changes in net assets. Of the totaled earned of approximately $48,036,000 was received through June 30, 2015. Accordingly the remaining balance of $1,466,000 is included in capitation and supplemental receivables on the accompanying consolidated statements of financial position. As of June 30, 2014, no amounts earned had been received and accordingly, $29,813,000 was included in capitation and supplemental receivables on the accompanying consolidated statements of financial position.

(1) Company operations and significant accounting policies (continued)

For fiscal years 2015 and 2014, capitation and supplemental receivables also include quality distributions to be received from AHCCCS, funded by deducting 1% from certain capitation premiums. This program was discontinued October 1, 2014. The quality withhold will be paid to the Plan according to the Plan's performance on selected performance measures relative to minimum performance standards. Management believes the Plan has met these standards and approximately $2,199,000 and $5,783,000 was earned from AHCCCS for these distributions for the years ended June 30, 2015 and 2014, respectively, which is included in capitation premiums in the accompanying consolidated statements of activities and changes in net assets. As of June 30, 2015 and 2014, no payments had been received on these amounts. Accordingly, approximately $7,982,000 and $5,783,000, respectively, is included in capitation and supplemental receivables on the accompanying consolidated statements of financial position as of June 30, 2015 and 2014.

Capitation and supplemental and reconciliation receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to capitation and supplemental and reconciliation receivables. Capitation and supplemental and reconciliation receivables at June 30, 2015 and 2014 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Mercy Maricopa receives substantially all of its revenue from its contracts with ADHS and CMS. Operating revenue includes funding in the form of capitation revenue, which is recognized over the applicable coverage period on a per member basis for covered members. Under this arrangement, Mercy Maricopa is paid a per member fee for all enrolled members, and this fee is recorded as revenue in the month in which members are entitled to services. Any fees received prior to the month of service are recorded as deferred revenue. Capitation revenues from ADHS and CMS totaled approximately $966,279,000 and $226,477,000 for the years ended June 30, 2015 and 2014, respectively. The ADHS contract is partially funded by federal, state, county and block grants (non-title revenue), which represent annual appropriations. Mercy Maricopa recognizes revenue from this funding ratably over the period to which the funding applies. Non-Title revenues, including block grants, totaled approximately $133,305,000 and $33,132,000 for the years ended June 30, 2015 and 2014, respectively.

Mercy Maricopa contract revenue is limited by the terms of the ADHS contract to a maximum profit percentage of four percent. ADHS contract revenue that cannot be recognized due to the profit limits for the contract period of April 1, 2014 through June 30, 2015 totaled approximately $117,000 and $707,000 for the years ended June 30, 2015 and 2014, respectively, and is included in Due to ADHS on the accompanying statements of financial position and represents a reduction in operating revenue.

Due from ADHS - At June 30, 2015 and 2014, due from ADHS consists primarily of amounts due for the provisions of housing and other services and for capitation payments under Mercy Maricopa's contract. The receivables are stated at the amount management expects to collect. The Company establishes an allowance for doubtful accounts, if necessary, based upon factors including credit risk, historical trends, and other information. As of June 30, 2015 and 2014, amounts due from ADHS are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

(1) Company operations and significant accounting policies (continued)

Delivery supplement - As part of the AHCCCS Acute Care contract, AHCCCS supplements capitation premiums with lump-sum payments for births by women eligible under the Medicaid program. This delivery supplement represents childbirth delivery reimbursement which is recorded when the delivery occurs. Delivery revenue of approximately $59,020,000 and $60,073,000 was recognized for the years ended June 30, 2015 and 2014, respectively. As of June 30, 2015 and 2014, approximately $521,000 and $158,000 was due from AHCCCS related to delivery supplement, respectively, which is included in capitation and supplemental receivables in the accompanying consolidated statement of financial position.

Premium taxes - SCHN is subject to a 2% tax on all payments received from AHCCCS for premiums, reinsurance, and reconciliations.

Reinsurance revenue - AHCCCS and DES/DDD provide a stop-loss reinsurance program for the Plan for partial reimbursement of reinsurable covered medical services incurred for members. The program includes a deductible, which varies based on the Plan's enrollment and the eligibility category of the members. AHCCCS and DES/DDD reimburse the Plan based on a coinsurance amount for reinsurable covered services incurred above the deductible. SCHN and Mercy Maricopa contract with commercial reinsurers to provide reinsurance for the Medicare Advantage Plans. Reinsurance revenue is stated at the actual and estimated amounts due to SCHN and Mercy Maricopa pursuant to the AHCCCS Acute, DES/DDD, ALTCS and Medicare Advantage Plan contracts.

Below are the reinsurance thresholds by line of business:

Line of Business	Annual Deductible Effective October 1, 2014	Annual Deductible Effective October 1, 2013	Coinsurance
AHCCCS Acute – Prospective Only	$ 25,000	$ 25,000	75%
DES/DDD	20,000	20,000	75%
ALTCS w/Medicare	20,000	20,000	75%
ALTCS w/o Medicare	30,000	30,000	75%

Line of Business	Annual Deductible Effective January 1, 2015	Annual Deductible Effective January 1, 2014	Coinsurance
SCHN Medicare Advantage	$ 750,000	$ 750,000	90%

Line of Business	Annual Deductible Effective April 1, 2014	Coinsurance
Mercy Maricopa Medicare Advantage – effective April 1, 2014 through September 30, 2015	$ 500,000	90%

(1) Company operations and significant accounting policies (continued)

To be eligible for reinsurance billing, qualified healthcare expenses must be incurred during the contract year. Reinsurance revenue is recorded based on actual billed reinsurance claims adjusted for medical cost completion factors and SCHN's historical collection experience. Reinsurance revenue is subject to review by AHCCCS, DES/DDD, and the Medicare Advantage Plan's commercial reinsurer, and as a result, there is at least a reasonable possibility that recorded reinsurance revenue will change by a material amount in the near future.

Reinsurance receivables represent the expected payment from AHCCCS, DES/DDD, and the Medicare Advantage Plan's commercial insurer to the Company for certain enrollees whose qualifying medical expenses paid by the Plan were in excess of specified deductible limits. Reinsurance receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to reinsurance receivables. At June 30, 2015 and 2014, gross reinsurance receivables totaled approximately $25,913,000 and $22,030,000, for SCHN and totaled approximately $446,000 and $0 for Mercy Maricopa, respectively. SCHN also had an allowance for doubtful accounts of approximately $7,069,000 and $4,692,000 at June 30, 2015 and 2014, respectively. As of June 30, 2015, Mercy Maricopa's reinsurance receivable balance is considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Pharmacy rebate receivable - The Company receives rebates from pharmaceutical companies based on the volume of drugs purchased. The Company records a receivable and a reduction of health care expenses for estimated rebates due based on purchase information. During the years ended June 30, 2015 and 2014, health care expenses were reduced by approximately $25,715,000 and $11,870,000 for rebates, respectively. At June 30, 2015 and 2014, management believes the pharmacy rebate receivables are fully collectible and accordingly, an allowance has not been established.

Third-party liability receivable - In cases such as motor vehicle accidents and worker's compensation claims, a third-party insurer may be liable for a claim. When SCHN pays claims on behalf of its members and determines a third-party insurance company is ultimately responsible for that claim, it estimates a receivable and recoups the claim cost from the third-party insurer. SCHN has hired an asset recovery company to manage the third-party receivable collections. Third-party liability receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to third-party liability receivable. At June 30, 2015 and 2014, gross third-party liability receivable totaled approximately $4,693,000 and $5,586,000, respectively. SCHN also had an allowance for doubtful accounts of approximately $1,517,000 and $958,000 at June 30, 2015 and 2014, respectively.

(1) Company operations and significant accounting policies (continued)

Provider advances - Upon request, SCHN and Mercy Maricopa may advance monies to high-volume providers based on cash flow needs and timing of claims payments. Advances are stated at the amount management expects to collect or offset against future claims. Advances are non-interest bearing and are expected to be settled within 12 months. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowances and a credit to provider advances receivable. At June 30, 2015 and 2014, gross provider advances receivable totaled approximately $7,688,000 and $6,213,000, respectively. SCHN also had an allowance for doubtful accounts of approximately $1,086,000 and $1,566,000 at June 30, 2015 and 2014, respectively. Mercy Maricopa's provider advance receivable balance is considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Risk share settlement - The risk share settlement includes expected payments to be paid to or received from CMS in connection with the pharmacy component of Medicare Advantage, Medicare Part D. This balance is reviewed and monitored by management and adjusted as necessary as experience develops or new information becomes available. Such adjustments are netted against the capitation premiums on the consolidated statements of activities and changes in net assets. The pharmacy risk share settlement for calendar year 2015 and 2014, recorded at June 30, 2015, is expected to be finalized in late 2016 and 2015, respectively. Amounts recorded under this program totaled approximately $(3,990,000) and $8,008,000 for the years ended June 30, 2015 and 2014, respectively, which are included as capitation premiums in the accompanying consolidated statements of activities and changes in net assets. The pharmacy risk share settlement is a receivable as of June 30, 2014 totaling $4,902,000 and a payable as of June 30, 2015 totaling $2,629,000. The pharmacy risk share settlement for calendar year 2013 is still open and is in a long term receivable position for $2,331,000. The risk share settlement receivable balance is considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Premium deficiency reserve - The Company evaluates possible losses on its contracts through the end of each contract year. If necessary, a premium deficiency reserve is recorded within medical claims payable on the consolidated statements of financial position. As of June 30, 2015, SCHN recorded a premium deficiency reserve of $2,769,000 for probable losses within its CMS contract through the end of the contract year ending December 31, 2015. As of June 30, 2015, Mercy Maricopa recorded a premium deficiency reserve of $1,551,000 for probable losses within its CMS contract through the end of the contract year ending December 31, 2015. No premium deficiency reserve for SCHN or Mercy Maricopa was considered necessary at June 30, 2014.

Healthcare service cost recognition - The costs of providing hospitalization, medical compensation, ancillary and other medical services, institutional, and home and community based services are accrued in the period in which the service is provided to eligible recipients based in part on estimates, including an accrual for services incurred but not yet reported to SCHN.

Mercy Maricopa contracts with various providers for the provision of a full range of integrated healthcare services to eligible adults and children for Title XIX, Title XXI, and Non-Title programs, and physical healthcare services to Seriously Mental Ill Title XIX eligible adults. Healthcare services are purchased under fee-for-service or block purchase arrangements. Fee-for-service contract expenses are accrued as incurred. Healthcare services provided under block purchase arrangements are accrued based upon contract terms. From time to time, Mercy Maricopa amends the provider contracts. The effects of these amendments are recorded in the period in which the amendment was executed.

(1) Company operations and significant accounting policies (continued)

The estimate for unreported services payable is developed using actuarial methods based on historical experience and are continually reviewed by management and adjusted as necessary based on current claims data, and medical cost completion factors. Such adjustments are included in health care expenses in the consolidated statements of activities and changes in net assets in each period when necessary. While management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. There is at least a reasonable possibility that the recorded estimates will change by a material amount, in the near future.

Payable to providers - Mercy Maricopa compensates providers for authorized healthcare and substance abuse services to covered beneficiaries. Mercy Maricopa uses a variety of methods to estimate the amount payable to providers including authorization for services to be provided, payments to be made under contract arrangements currently in force, and correspondence with significant providers to ascertain the level of care being provided to beneficiaries for which a claim has not yet been submitted.

Investments - Investments are recorded in accordance with FASB ASC 958-320, *Investments-Debt and Equity Securities* and FASB ASC 958-325, *Not-for-Profit Entities Investments – Other*. Under FASB ASC 958-320 and FASB ASC 958-325, the Company reports investments in equity securities that have readily determinable fair values, and all investments in debt securities at fair value based on quoted market prices. Investment securities without quoted market prices are valued at estimated fair value using appropriate valuation methods that consider the underlying assets. SCHN's investment portfolio is managed by professional investment managers within guidelines established by SCHN's Board of Directors which, as a matter of policy, limits the amounts which may be invested in any one issuer or type of investment.

Investment securities in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the near term could materially affect account balances and the amounts reported in the accompanying consolidated financial statements.

Restricted securities - At June 30, 2015 and 2014, restricted securities consists of U.S. Treasury notes held by a bank required to remain in trust by the State of Arizona, Department of Insurance for the duration of Mercy Maricopa's contract with ADHS. Mercy Maricopa may not make withdrawals on the account without prior approval from the State of Arizona, Department of Insurance. The purchases and sales of restricted securities are recorded on a trade-date basis. Interest is recognized on the accrual basis.

Fair value measurements - FASB ASC 820, *Fair Value Measurements*, establishes a common definition for fair value to be applied to accounting principles generally accepted in the United States of America requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. FASB ASC 820 also establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values by requiring that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2: Unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.

Level 3: Unobservable inputs for the asset or liability.

(1) Company operations and significant accounting policies (continued)

Investment income - Investment income consists of interest, dividends, and realized gains and losses on investments. Interest is recognized on the accrual basis, and dividends are recorded as earned on the ex-dividend date. Interest income on mortgage-backed and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Accrual of income is suspended for bonds and mortgage loans that are in default or when the receipt of interest payments is in doubt. Accrual of income has not been suspended for any bonds or mortgage loans during the years ended June 30, 2015 and 2014. The Company has a policy to review and identify investments with declines in value that would be considered to be other-than-temporary. Such other-than-temporary declines, if significant, are accounted for as realized losses (See Note 3).

Capitalized software costs - Research and development costs are charged to expense as incurred. However, the costs incurred for the development or purchase of computer software that relate to the implementation of the claims processing system are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated useful lives and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when the product is available for release and installation. Amortization is provided on a straight-line method over periods not exceeding five to seven years. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product is expensed immediately. Capitalized software cost totaled approximately $3,845,000 at June 30, 2015 and 2014. Effective April 1, 2014, the software was completed and placed into service, at which time Mercy Maricopa commenced amortization. Amortization expense totaled $769,000 and $192,000 for the years ended June 30, 2015 and 2014, respectively. Accumulated amortization was $961,000 and $192,000 as of June 30, 2015 and 2014, respectively.

Income taxes - SCHN and Mercy Maricopa qualify as tax exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the “Code”) and, therefore, there is no provision for income taxes included in the accompanying consolidated financial statements. Income determined to be unrelated business taxable income (UBTI) would be taxable.

FASB ASC 740-10, *Income Taxes*, relates to the accounting for uncertainty in income taxes which requires the application of a “more likely than not” threshold recognition and de-recognition of uncertain tax positions in operations in the year of such change. The Company evaluates its uncertain tax positions, if any, on a continual basis through review of their policies and procedures, review of their regular tax flings, and discussions with outside experts. At June 30, 2015 and 2014, the Company did not have any uncertain tax positions.

SCHN’s Federal Exempt Organization Business Income Tax Returns (Form 990) for 2012, 2013, and 2014 are subject to examination by the IRS, generally for the three years after they were filed. Mercy Maricopa’s Federal Exempt Organization Business Income Tax Returns (Form 990) for 2013 and 2014 are subject to examination by the IRS, generally for the three years after they were filed. As of the date of this report, the fiscal 2015 tax returns for either organization had not yet been filed.

(1) Company operations and significant accounting policies (continued)

Performance indicator - The consolidated statement of activities and changes in net assets includes the performance indicator operating income (loss). The performance indicator excludes non-operating income (expense) and net unrealized investment gains (losses), which is consistent with industry practice.

Recent accounting pronouncement - In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. Additionally, the guidance requires disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized. The amendments are required to be adopted for the Company's June 30, 2020 financial statements. Early adoption is permitted. Transition to the new guidance may be done using either a full or modified retrospective method. The Company is currently evaluating the impact of adopting ASU 2014-09.

Subsequent events - The Company has evaluated subsequent events through October 26, 2015, which is the date the consolidated financial statements were available to be issued.

(2) Reconciliation

Reconciliation balances are recorded as a net receivable or payable on the consolidated statement of financial position by line of business. A summary of the balances by line of business for the years ended June 30 are as follows (in thousands):

	2015		2014	
	Reconciliation Receivable	Reconciliation Payable	Reconciliation Receivable	Reconciliation Payable
Acute	$ 5,252	$ 29,808	$ 12,450	$ 7,167
ALTCS	6,557	129	7,330	3
DES/DDD	-	-	-	-
Total	11,809	29,937	19,780	7,170
Less current portion	(11,809)	(29,937)	(19,780)	(7,170)
Non-current portion	$ -	$ -	$ -	$ -

(3) Investments

The cost and fair value of the Company's investments by type at June 30 are as follows (in thousands):

	2015		2014	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Short-term:				
Marketable equity securities	$ 16,635	$ 16,635	$ 14,065	$ 14,065
Corporate bonds	2,676	2,653	3,044	3,036
	19,311	19,288	17,109	17,101
Long-term:				
Marketable equity securities	36,649	44,594	33,982	44,925
U.S. Government securities	20,118	20,185	12,265	12,304
Corporate bonds	27,081	27,635	32,155	33,463
Mortgage-backed securities	7,851	7,898	9,366	9,444
Preferred securities	5,250	5,656	4,037	4,432
	96,949	105,968	91,805	104,568
	$ 116,260	$ 125,256	$ 108,914	$ 121,669
Restricted securities	$ 520	$ 520	$ 520	$ 521

Investment income for the years ended June 30 is comprised of the following (in thousands):

	2015	**2014**
Interest and dividend income	$ 2,209	$ 3,500
Realized gains on investments	5,406	13,905
	$ 7,615	$ 17,405

Management continually reviews their investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost. During the years ended June 30, 2015 and 2014, the Company recorded no losses for other-than-temporary declines in the fair value of investments.

The following table summarizes the unrealized losses on investments held at June 30, 2015 (in thousands):

	Less than twelve months		Twelve months or longer		Total	
Description of securities	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
U.S. Government securities	$ -	$ -	$ 11,142	$ 12	$ 11,142	$ 12
Marketable equity securities	-	-	7,796	397	7,796	397
Corporate bonds	1,185	27	16,318	188	17,503	215
Mortgage-backed securities	-	-	1,680	1	1,680	1
Preferred securities	-	-	1,502	19	1,502	19
Total	$ 1,185	$ 27	$ 38,438	$ 617	$ 39,623	$ 644

(3) Investments (continued)

The following table summarizes the unrealized losses on investments held at June 30, 2014 (in thousands):

Description of securities	Less than twelve months		Twelve months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government securities	$ -	$ -	$ 1,092	$ 1	$ 1,092	$ 1
Marketable equity securities	-	-	979	45	979	45
Corporate bonds	1,570	26	9,591	48	11,161	74
Mortgage-backed securities	-	-	1,647	2	1,647	2
Preferred securities	-	-	502	5	502	5
Total	$ 1,570	$ 26	$ 13,811	$ 101	$ 15,381	$ 127

Investments classified as long-term are based on Management's intent to hold such investments. Long-term investments can be liquidated without significant penalty within twenty-four hours, and are considered short-term for purposes of calculating current ratios under AHCCCS reporting guidelines.

(4) Fair value measurements

The following table sets forth by level, within the fair value hierarchy, the Company's investments at fair value as of June 30, 2015 (in thousands):

	Level 1	Level 2	Level 3	Total
Investments:				
U.S. government securities	$ -	$ 20,185	$ -	$ 20,185
Marketable equity securities				
U.S. large cap	44,594	-	-	44,594
Money market mutual funds	11,850	-	-	11,850
Other	4,785	-	-	4,785
Total marketable equity securities	61,229	-	-	61,229
Corporate bonds	-	30,288	-	30,288
Mortgage-backed securities	-	7,898	-	7,898
Preferred securities	5,656	-	-	5,656
Total Investments	$ 66,885	$ 58,371	$ -	$ 125,256
Restricted securities	$ -	$ 520	$ -	$ 520

(4) Fair value measurements (continued)

The following table sets forth by level, within the fair value hierarchy, the Company's investments at fair value as of June 30, 2014 (in thousands):

	(Level 1)	(Level 2)	(Level 3)	Total
Investments:				
U.S. government securities	$ -	$ 12,304	$ -	$ 12,304
Marketable equity securities				
U.S. large cap	44,925	-	-	44,925
Money market mutual funds	11,845	-	-	11,845
Other	2,220	-	-	2,220
Total marketable equity securities	58,990	-	-	58,990
Corporate bonds	-	36,499	-	36,499
Mortgage-backed securities	-	9,444	-	9,444
Preferred securities	4,432	-	-	4,432
Total Investments	$ 63,422	$ 58,247	$ -	$ 121,669
Restricted securities	$ -	$ 521	$ -	$ 521

For financial instruments not addressed previously and not reported at fair value, the carrying amounts approximate fair value because of the short maturities of the following: cash and cash equivalents, receivables, due from ADHS, due from District, medical claims payable, payable to providers, reconciliation payable, due to Aetna, due to ADHS and other current liabilities.

(5) Medical claims payable

On a consolidated basis at June 30, 2015 and 2014, claims outstanding to third parties for health care services provided to members, including estimates for incurred but not reported claims, were approximately $243 million and $201 million (SCHN $168 and $142 million and Mercy Maricopa $75 and $59 million), respectively. The balances at June 30, 2015 and 2014 were certified by an actuary. Activity in the liability for medical claims payable and health care expense for the years ended June 30, 2015 and 2014 is as follows (in thousands):

	2015	2014
Balance at July 1	$ 200,508	$ 157,277
Incurred related to:		
Current year	2,184,178	1,713,340
Prior years	17,395	(6,333)
Total incurred	2,201,573	1,707,007
Paid related to:		
Current year	(1,967,679)	(1,510,453)
Prior years	(191,708)	(153,323)
Total paid	(2,159,387)	(1,663,776)
Balance at June 30	$ 242,694	$ 200,508

Estimates for incurred claims are based on historical enrollment, cost trends, and consider operational changes. Future actual results will typically differ from the estimates. Differences could be due to factors such as an overall change in medical expenses per member or a change in client mix affecting medical costs due to the addition of new members.

(5) Medical claims payable (continued)

The liability for SCHN claims unpaid at June 30, 2014 underestimated the actual claims incurred related to fiscal year 2014 and prior by approximately $13.9 million or 11% of SCHN claims unpaid. The liability for SCHN claims unpaid at June 30, 2013 exceeded the actual claims incurred related to fiscal year 2013 and prior by approximately $14.6 million or 10% of SCHN claims unpaid. The primary drivers for the unfavorable claim development include member mix changes, changes in claims processing patterns and inventory levels used in the estimate. The liability for Mercy Maricopa claims payable at June 30, 2015 was more than the actual claims incurred related to fiscal year 2014 and prior by approximately 12,398,000 or 21%. The primary drivers for favorable claim development for Mercy Maricopa include member mix changes and lower than anticipated member utilization. SCHN and Mercy Maricopa continue to incur claims for prior periods. The medical claims payable is adjusted each period end as more information becomes available.

Estimated third-party subrogation included as a reduction to medical and hospital expenses in the accompanying consolidated statements of activities and changes in net assets at June 30, 2015 and 2014 totaled approximately $3,448,000 and $2,850,000, respectively.

(6) Due to/from District

During the period from formation (January 22, 2013) through June 30, 2013, District contributed $5 million towards the initial funding of Mercy Maricopa. Additionally, in accordance with a promissory note agreement between Mercy Maricopa and District dated September 9, 2013, District agreed to pay Mercy Maricopa an additional $5 million for a total of $10 million contributed. The promissory note was due April 1, 2015, one year after the implementation of the RBHA contract for GSA 6 awarded to Mercy Maricopa. The promissory note bore no interest through the maturity date and was unsecured. At June 30, 2014, $5 million was outstanding under the promissory note. The promissory note was collected in full as of June 30, 2015.

In accordance with the membership agreement, any time after three years from the commencement of the ADHS RBHA contract (April 1, 2014), District may require that Mercy Maricopa purchase the membership interest of District. The purchase price of District's membership interest under the District put option shall be the sum of District's capital contributions to Mercy Maricopa, without interest, and any remaining accrued or deferred distributions to District (a 15% relative interest), plus interest, if any. As a result of the put option within the membership agreement, $12,860,000 (the $10 million, plus District's share of the changes in Mercy Maricopa's net assets since formation of $2,860,000) and $8,968,000 is presented as a long-term liability, included in Due to District, within the accompanying statements of financial position at June 30, 2015 and 2014, respectively.

(7) Related party transactions

The Company paid approximately $97,740,000 in 2015 and $74,797,000 in 2014 to Dignity, paid approximately $23,054,000 in 2015 and $22,748,000 in 2014 to Carondelet, and paid approximately $30,573,000 in 2015 and $2,442,000 in 2014 to District for hospitalization, behavioral health and other medical services provided to its members. These balances include net prospective provider advance payments made to Dignity and Carondelet. At June 30, 2015, provider advances to Dignity and Carondelet amounted to approximately $3,781,000 and $9,000 respectively. At June 30, 2014, provider advances to Dignity and Carondelet amounted to approximately $3,047,000 and $0, respectively. During the year ended June 30, 2015 SCHN made net asset distributions of $15,000,000 and $15,000,000 to both Dignity and Carondelet, respectively. During the year ended June 30, 2014 SCHN made net asset distributions of $20,000,000 and $20,000,000 to both Dignity and Carondelet, respectively. The distributions were approved by AHCCCS.

(8) Commitments and contingencies

Performance bonds - SCHN obtains unsecured surety bonds to satisfy the AHCCCS Acute, ALTCS, DES/DDD and Medicare performance bond requirements. The following table sets forth the contract requirement and the Performance Bond amounts at June 30, 2015:

Line of Business	AHCCCS Requirement	Performance Bond Amount		Effective Date
Acute	100% of Capitation Revenue	$	90,000,000	6/11/2015
ALTCS	80% of Capitation Revenue	$	32,000,000	12/1/2014
DDD	80% of Capitation Revenue	$	3,000,000	12/1/2014
Medicare	$1,050 PMPM	$	19,300,000	12/1/2014

In accordance with the terms of its contract with ADHS, Mercy Maricopa is required to post a performance bond with ADHS equal to 80% of the expected monthly Title capitation and Non-Title payments, as specified in the contract. The amount of the bond is subject to adjustment as certain conditions change and its method of calculation is specified in the contract. The performance bond must be maintained to guarantee payment of Mercy Maricopa's obligations under the contract. The performance bond requirement was $72,066,000 and $65,064,000 for the years ended June 30, 2015 and 2014, respectively. The performance bond requirement was met through the purchase of three performance bonds totaling $72,100,000 and 65,500,000 for the years ended June 30, 2015 and 2014, respectively.

Litigation - Periodically, the Company is involved in litigation and claims arising in the normal course of operations. In the opinion of management based on consultation with legal counsel, losses, if any, from these matters are covered by insurance or are immaterial. Management believes that any resulting liability, if any, will not materially affect the Company's consolidated financial position.

On March 25, 2013, the Company was awarded a contract with ADHS covering the GSA of Maricopa County. This new contract was to take effect October 1, 2013; however, the prior contract holder filed a legal challenge and requested and received a stay order requiring the contract to remain with the prior contract holder until the legal challenge had been decided. On December 3, 2013, the Deputy Director of the Arizona Department of Administration issued an Order affirming the Arizona Department of Health Services award of the GSA 6 Integrated Care RBHA contract to Mercy Maricopa effective April 1, 2014.

Liability insurance - The Company maintains professional insurance coverage under claims-made policies. The Company is insured for losses up to $10 million per claim and in the aggregate, with a self-insured retention of $150,000 under its professional liability policy. Claims reported endorsement (tail) coverage is available if the policy is not renewed to cover claims incurred but not reported. The Company anticipates that renewal coverage will be available at expiration of the current policy. Mercy Maricopa maintains directors and officers, errors and omissions, and cyber liability insurance coverage under claims-made policies. Mercy Maricopa is insured for losses up to $20 million per claim and in the aggregate under its directors and officers liability policy. Mercy Maricopa is insured for losses up to $10 million per claim and in the aggregate under its each of its errors and omissions and cyber liability policies. Claims reported endorsement (tail) coverage is available if the policy is not renewed to cover claims incurred but not reported. Mercy Maricopa anticipates that renewal coverage will be available at expiration of the current policy. Aetna maintains the general liability coverage for the Company, and is insured for losses up to $2 million per claim and $4 million in the aggregate under its general liability policy.

(8) Commitments and contingencies (continued)

Healthcare regulation - The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future reviews and interpretation as well as regulatory actions unknown or unasserted at this time.

Health reform legislation at both the federal and state levels continues to evolve. Changes continue to impact existing and future laws and rules. Such changes may impact the way the Company does business, restrict revenue and enrollment growth in certain products and market segments, restrict premium growth rates for certain products and market segments, increase medical, administrative and capital costs, and expose the Company to increased risk of loss or further liabilities. The Company's consolidated operating results, financial position and cash flows could be adversely impacted by such changes.

Community reinvestment program - Mercy Maricopa has approved a Community Reinvestment program. Under the program, Mercy Maricopa will place 5% of its total change in net assets for the purposes of community reinvestment. The program funds community projects that enhance the lives of people in the communities in Mercy Maricopa's geographic service area. These funds are for projects and services not eligible for service or prevention dollars from Mercy Maricopa.

For the years ended June 30, 2015 and 2014, Mercy Maricopa approved amounts that resulted in expenses of approximately $1,647,000 and $274,000, respectively, to be spent on various healthcare community projects. These amounts are included in general and administrative expenses in the accompanying consolidated statements of activities and changes in net assets. At June 30, 2015 and 2014, Mercy Maricopa had not yet spent all of the funds appropriated. Accordingly, at June 30, 2015 and 2014, Mercy Maricopa has recorded a liability for unspent community reinvestment program funds of $1,925,000 and $274,000, respectively, which is included in other current liabilities.

Contract compliance - Under the terms of the AHCCCS and Medicare Advantage (MCA) contracts, SCHN is required to meet certain financial covenants for both AHCCCS and CMS products, as applicable. As of June 30, 2015 and 2014, SCHN is in compliance with the AHCCCS covenants and CMS financial covenants, as applicable, except for the equity per member per month required under the MCA program. At June 30, 2015 the equity per member per month was below the AHCCCS requirement for the MCA program. To resolve the shortfall SCHN transferred equity from the Acute line of business to the Medicare line of business subsequent to June 30, 2015.

In accordance with the ADHS Contract, Mercy Maricopa is required to maintain certain minimum financial reporting and viability measures.

Mercy Maricopa must maintain unrestricted minimum capitalization of at least 90% of the monthly capitation and block payments received under the Contract. As of June 30, 2015, the Company was in compliance with this requirement.

The Contract contains various quarterly financial performance requirements, including a required minimum liquidity ratio, an administrative cost percentage, and service expense percentages. As of June 30, 2015 the Company was in compliance with these requirements.

(8) Commitments and contingencies (continued)

As discussed in Note 1, the Company is limited by the terms of its contract with ADHS to profit that can be earned under the various programs.

Should Mercy Maricopa be in default of any material obligations under the Contract, ADHS may, at its discretion, in addition to other remedies, either adjust the amount of future payments or withhold future payment until satisfactory resolution of the default or exception. Further, if monies are not appropriated by the State or are not otherwise available, the Contract may be cancelled upon written notice until such monies are so appropriated or available.

Mercy Maricopa is required to meet quarterly and contract year end minimum encounter submission percentages, or be subject to sanction by ADHS. Typically, Mercy Maricopa has up to eight months after the contract period end to meet the minimum number of encounters. Mercy Maricopa anticipates meeting required encounter threshold for the eighteen month contract period from April 1, 2014 through September 30, 2015. Accordingly, as of June 30, 2015 and 2014, Mercy Maricopa has not recorded a liability associated with an encounter sanction.

ADHS has a right to sanction Mercy Maricopa for other matters of non-compliance of the Contract, as determined by ADHS. Mercy Maricopa received sanctions of $131,000 and $0 from ADHS for the years ended June 30, 2015 and 2014, respectively. Sanctions are included in Mercy Maricopa's management agreement with Aetna and as such, no additional expense is reflected in the accompanying financial statements.

(9) Concentration of credit risk

SCHN's future contract awards are contingent upon the continuation of the AHCCCS Acute, DES/DDD, and ALTCS programs by the State of Arizona and SCHN's ability and desire to retain its status as a contractor under these programs. The AHCCCS Acute contract is effective through September 30, 2016, with two additional one year renewal options. The ALTCS contract will expire on September 30, 2015, with one additional one year renewal option. The DES/DDD contract was renewed through September 30, 2015. Mercy Maricopa currently holds a contract with the ADHS to provide services through September 2016, with two additional one year renewal options. The Medicare Advantage contracts are renewed annually by CMS. Failure to renew these contracts could have a significant impact on operations.

Mercy Maricopa currently holds a contract with the ADHS to provide services through September 2016, with two additional one year renewal options. The Medicare Advantage contract is renewed annually by CMS. Failure to renew these contracts could have a significant impact on operations.

(10) Subsequent events

Mercy Maricopa has not renewed its Medicare Advantage Plan with CMS and is discontinuing the plan effective December 31, 2015. For the year ended June 30, 2015, capitation revenue for the Medicare Advantage Plan was approximately $28,000,000 and the net loss from the program was approximately $5,000,000.

Effective October 1, 2015, due to changes in the RBHA contracts with ADHS, Mercy Maricopa will no longer provide General Mental Health and Substance Abuse services to the dually eligible membership population. The General Mental Health and Substance Abuse dually eligible members are estimated to be 57,000 with annualized revenue of approximately $27,000,000.

ADDITIONAL INFORMATION

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INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

To the Board of Directors of

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

We have audited the consolidated financial statements of ***Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate*** as of and for the years ended June 30, 2015 and 2014, and our report thereon dated October 26, 2015, which contained an unmodified opinion on those consolidated financial statements, appears on pages 1 - 2. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental statements - SCHN on pages 27 through 28 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. The consolidating information on pages 25 and 26 are presented for purposes of additional analysis of the 2015 consolidated financial statements rather than to present the financial position, activities and changes in net assets of the individual entities and are not a required part of the consolidated financial statements. The additional information on pages 25 through 28 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Mayer Hoffman McCann P.C.

Phoenix, Arizona
October 26, 2015

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

ADDITIONAL INFORMATION

CONSOLIDATING STATEMENT OF FINANCIAL POSITION

June 30, 2015
(In thousands)

ASSETS

	SCHN	Mercy Maricopa	Eliminations	Consolidated
CURRENT ASSETS				
Cash and cash equivalents	$ 82,166	$ 169,510	$ -	$ 251,676
Short-term investments	19,288	-	-	19,288
Receivables:				
Reinsurance receivables, net of allowance for doubtful accounts of $7,069 for 2015 and $4,692 for 2014	18,844	446	-	19,290
Reconciliation receivables	11,809	-	-	11,809
Capitation and supplemental receivables	8,304	520	-	8,824
Pharmacy rebate receivables	10,323	1,849	-	12,172
Third-party liability receivable, net of allowance for doubtful accounts of $1,517 for 2015 and $958 for 2014	3,176	-	-	3,176
Interest receivable	321	-	-	321
Provider advances, net of allowance for doubtful accounts of $1,086 for 2015 and $1,566 for 2014	5,385	1,217	-	6,602
Other receivables	359	-	-	359
Risk share settlement	14,349	770	-	15,119
Due from ADHS	-	12,967	-	12,967
Due from Aetna	10,302	159	-	10,461
Prepaid assets	753	1,071	-	1,824
TOTAL CURRENT ASSETS	185,379	188,509	-	373,888
RESTRICTED SECURITIES	-	520	-	520
CAPITALIZED SOFTWARE COSTS, net	-	2,884	-	2,884
RISK SHARE SETTLEMENT, less current portion	2,331	-	-	2,331
INVESTMENT IN MMIC	96,204	-	(96,204)	-
LONG-TERM INVESTMENTS	105,968	-	-	105,968
TOTAL ASSETS	$ 389,882	$ 191,913	$ (96,204)	485,591

LIABILITIES AND NET ASSETS

	SCHN	Mercy Maricopa	Eliminations	Consolidated
CURRENT LIABILITIES				
Medical claims payable	$ 168,261	$ 74,433	$ -	$ 242,694
Payable to providers	-	5,973	-	5,973
Reconciliation payable	29,937	-	-	29,937
Due to ADHS	-	117	-	117
Deferred revenue	-	225	-	225
Other current liabilities	9,040	2,101	-	11,141
TOTAL CURRENT LIABILITIES	207,238	82,849	-	290,087
RISK SHARE SETTLEMENT PAYABLE	2,629	-	-	2,629
DUE TO DISTRICT	-	12,860	-	12,860
TOTAL LIABILITIES	209,867	95,709	-	305,576
UNRESTRICTED NET ASSETS	180,015	96,204	(96,204)	180,015
TOTAL LIABILITIES AND NET ASSETS	$ 389,882	$ 191,913	$ (96,204)	$ 485,591

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

ADDITIONAL INFORMATION

CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2015
(In thousands)

	SCHN	Mercy Maricopa	Eliminations	Consolidated
OPERATING REVENUES				
Capitation premiums	$ 1,845,638	$ 1,099,467	$ -	$ 2,945,105
Delivery supplement	59,020	-	-	59,020
Reinsurance	52,260	760	-	53,020
Other, primarily third party recoveries	1,936	-	-	1,936
TOTAL OPERATING REVENUES	1,958,854	1,100,227	-	3,059,081
HEALTH CARE EXPENSES				
Hospitalization	331,576	-	-	331,576
Medical compensation	313,902	-	-	313,902
Ancillary and other medical services	782,965	987,659	-	1,770,624
Institutional	189,689	-	-	189,689
Home and community based services	173,772	-	-	173,772
TOTAL HEALTH CARE EXPENSES	1,791,904	987,659	-	2,779,563
GENERAL AND ADMINISTRATIVE EXPENSES	126,802	86,631	-	213,433
PREMIUM TAX EXPENSE	33,500	-	-	33,500
TOTAL EXPENSES	1,952,206	1,074,290	-	3,026,496
OPERATING INCOME	6,648	25,937	-	32,585
NONOPERATING INCOME (EXPENSE)				
Investment income	7,610	5	-	7,615
Investment fees	(570)	-	-	(570)
Investment income from MMIC	22,050	-	(22,050)	-
TOTAL NONOPERATING INCOME	29,090	5	(22,050)	7,045
CHANGE IN NET ASSETS PRIOR TO UNREALIZED LOSSES ON INVESTMENTS	35,738	25,942	(22,050)	39,630
UNREALIZED LOSSES ON INVESTMENTS	(3,761)	(1)	-	(3,762)
CHANGE IN NET ASSETS PRIOR TO CAPITAL CONTRIBUTIONS, DISTRIBUTIONS AND CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	31,977	25,941	(22,050)	35,868
CONTRIBUTIONS FROM MEMBER ORGANIZATION	-	25,000	(25,000)	-
DISTRIBUTIONS TO SPONSOR ORGANIZATIONS	(30,000)	-	-	(30,000)
CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	-	(3,891)	-	(3,891)
CHANGE IN NET ASSETS	1,977	47,050	(47,050)	1,977
NET ASSETS, BEGINNING OF YEAR	178,038	49,154	(49,154)	178,038
NET ASSETS, END OF YEAR	$ 180,015	$ 96,204	$ (96,204)	$ 180,015

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

ADDITIONAL INFORMATION

SUPPLEMENTAL STATEMENT OF FINANCIAL POSITION - SCHN

June 30, 2015
(In thousands)

ASSETS

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
CURRENT ASSETS						
Cash and cash equivalents	$ 55,003	$ 305	$ (237)	$ 23,950	$ 3,145	$ 82,166
Short-term investments	9,893	1,235	-	7,237	923	19,288
Receivables:						
Reinsurance receivables, net	10,190	907	-	7,747	-	18,844
Reconciliation receivables	5,251	-	-	6,558	-	11,809
Capitation and supplemental receivables	1,305	-	-	(91)	7,090	8,304
Pharmacy rebate receivables	3,079	139	-	187	6,918	10,323
Third party liability receivable, net	2,636	-	-	540	-	3,176
Interest receivable	165	21	-	120	15	321
Provider advances, net	2,347	74	-	680	2,284	5,385
Other receivables	358	1	-	-	-	359
Risk share settlement	9,448	-	-	-	4,901	14,349
Due from Aetna	5,201	231	-	2,628	2,242	10,302
Prepaid assets	442	4	-	49	258	753
TOTAL CURRENT ASSETS	105,318	2,917	(237)	49,605	27,776	185,379
RISK SHARE SETTLEMENT, less current portion	-	-	-	-	2,331	2,331
INVESTMENT IN MMIC	58,902	-	-	26,921	10,381	96,204
LONG-TERM INVESTMENTS	54,353	6,789	-	39,758	5,068	105,968
TOTAL ASSETS	$ 218,573	$ 9,706	$ (237)	$ 116,284	$ 45,556	$ 389,882

LIABILITIES AND NET ASSETS

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
CURRENT LIABILITIES						
Medical claims payable	$ 78,135	$ 3,506	$ -	$ 58,130	$ 28,490	$ 168,261
Reconciliation payable	29,808	-	-	129	-	29,937
Other current liabilities	5,104	109	-	1,508	2,319	9,040
TOTAL CURRENT LIABILITIES	113,047	3,615	-	59,767	30,809	207,238
RISK SHARE SETTLEMENT PAYABLE	-	-	-	-	2,629	2,629
TOTAL LIABILITIES	113,047	3,615	-	59,767	33,438	209,867
UNRESTRICTED NET ASSETS	105,526	6,091	(237)	56,517	12,118	180,015
TOTAL LIABILITIES AND NET ASSETS	$ 218,573	$ 9,706	$ (237)	$ 116,284	$ 45,556	$ 389,882

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

ADDITIONAL INFORMATION

SUPPLEMENTAL STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS - SCHN

Year Ended June 30, 2015
(In thousands)

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
OPERATING REVENUES						
Capitation premiums	$ 987,292	$ 42,294	$ 5	$ 468,810	$ 347,237	$ 1,845,638
Delivery supplement	59,020	-	-	-	-	59,020
Reinsurance	26,204	1,463	-	24,593	-	52,260
Other, primarily third party recoveries	1,010	68	(83)	393	548	1,936
TOTAL OPERATING REVENUES	1,073,526	43,825	(78)	493,796	347,785	1,958,854
HEALTH CARE EXPENSES						
Hospitalization	191,965	6,196	141	19,027	114,247	331,576
Medical compensation	257,899	6,107	1	12,895	37,000	313,902
Ancillary and other medical services	510,474	28,379	16	64,347	179,749	782,965
Institutional	-	-	-	189,689	-	189,689
Home and community based services	-	-	-	173,772	-	173,772
TOTAL HEALTH CARE EXPENSES	960,338	40,682	158	459,730	330,996	1,791,904
GENERAL AND ADMINISTRATIVE EXPENSES	69,465	2,865	1	25,583	28,888	126,802
PREMIUM TAX EXPENSE	23,067	-	-	10,433	-	33,500
TOTAL EXPENSES	1,052,870	43,547	159	495,746	359,884	1,952,206
OPERATING INCOME (LOSS)	20,656	278	(237)	(1,950)	(12,099)	6,648
NONOPERATING INCOME (EXPENSE)						
Investment income	3,903	488	-	2,855	364	7,610
Investment fees	(292)	(37)	-	(214)	(27)	(570)
Investment in MMIC	12,831	-	-	6,843	2,376	22,050
TOTAL NONOPERATING INCOME	16,442	451	-	9,484	2,713	29,090
CHANGE IN NET ASSETS PRIOR TO UNREALIZED LOSSES ON INVESTMENTS	37,098	729	(237)	7,534	(9,386)	35,738
UNREALIZED LOSSES ON INVESTMENTS	(1,654)	(225)	-	(1,680)	(202)	(3,761)
CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS	35,444	504	(237)	5,854	(9,588)	31,977
DISTRIBUTIONS TO SPONSOR ORGANIZATIONS	(10,383)	(3,000)	(10,617)	(3,000)	(3,000)	(30,000)
CHANGE IN NET ASSETS	25,061	(2,496)	(10,854)	2,854	(12,588)	1,977
NET ASSETS, BEGINNING OF YEAR	80,465	8,587	10,617	53,663	24,706	178,038
NET ASSETS END OF YEAR	$ 105,526	$ 6,091	$ (237)	$ 56,517	$ 12,118	$ 180,015