

FINANCIAL STATEMENTS

Maricopa Health Plan  
(A Department of Maricopa Integrated Health System)  
Years Ended June 30, 2016 and 2015  
With Report of Independent Auditors

Ernst & Young LLP



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## Report of Independent Auditors

The Board of Directors  
Maricopa County Special Health Care District  
d/b/a Maricopa Integrated Health System  
Phoenix, Arizona

We have audited the accompanying financial statements of Maricopa Health Plan (a department of Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System) (MHP) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise MHP's financial statements as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

**Maricopa Health Plan**  
(A Department of Maricopa Integrated Health System)

**Management's Discussion and Analysis**

**Introduction**

Maricopa Health Plan (MHP), a department of Maricopa Integrated Health System (MIHS), offers readers of its financial statements this narrative overview of the current financial position, results of operations, and cash flows for MHP for the years ended June 30, 2016 and 2015. The narrative within contains required supplemental information, which should be read in conjunction with MHP's audited financial statements, including the notes thereto.

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to MHP's audited financial statements. The financial statements are composed of the statements of net position, the statements of revenues, expenses and changes in net position, and the statements of cash flows. The financial statements also include notes to the financial statements that explain in more detail some of the information in the financial statements. The financial statements are designed to provide readers with a broad overview of MHP's finances.

These statements offer short- and long-term information about MHP's activities. The statements of net position include all of MHP's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to MHP's creditors (liabilities). The statements of net position also provide the basis for evaluating the capital structure of MHP and assessing the liquidity and financial flexibility of MHP.

All of the current year's revenues and expenses are accounted for in the statements of revenues, expenses, and changes in net position. These statements measure the financial performance of MHP's operations and can be used to determine whether MHP has successfully recovered all of its costs through its revenue sources. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final required statements are the statements of cash flows. These statements report the cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities. They also provide answers to where cash came from, what cash was used for, and what the change in cash balance was during the reporting period.

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Management's Discussion and Analysis (continued)

*Assets:* MHP's total assets are \$68,072,522 and \$65,866,503 as of June 30, 2016 and 2015, respectively. MHP has no assets held in bonds or money market mutual funds. MHP has no assets held in foreign investments, investments with contractual sales restrictions, equity interests, or in nonaffiliated, privately placed equities. MHP has neither mortgage loans nor any assets held in real estate.

At June 30, 2016 and 2015, respectively, MHP reported a receivable of \$174,589 and \$92,408 for capitation and supplemental revenue and \$5,183,227 and \$2,723,772 for reconciliation receivable due from AHCCCS.

MHP receives reinsurance coverage from the State of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The gross capitation rates were reduced by the reinsurance cost. Under the state program, risk of loss for inpatient claims is generally limited to an annual deductible of \$25,000 for 2016 and 2015 per member, per policy year. Eligible claims in excess of the deductible are generally paid by the state at 75% to 85% of amount paid by the plan, with no maximum annual benefit. MHP's reinsurance receivable reported at June 30, 2016 and 2015, was \$4,328,233 and \$3,507,042, respectively.

*Liabilities:* MHP reported total liabilities of \$48,610,003 and \$47,190,374 as of June 30, 2016 and 2015, respectively. As of June 30, 2016 and 2015, respectively, MHP reported \$8,558,025 and \$16,444,655 for reconciliation payable due to AHCCCS.

At June 30, 2016 and 2015, MHP reported \$31,763,100 and \$25,678,037, respectively, for medical claims payable. The costs of hospital and medical services provided to enrollees served under contract are recognized in the period that the services are rendered. A provision has been made for claims in process of review and for claims incurred but not reported at year-end. The amount of this liability is computed using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term. Management believes that the medical claims payable is adequate.

*Net Position:* MHP had ending net position of \$19,462,519 and \$18,676,129 at June 30, 2016 and 2015, respectively. The increase of \$786,390 is the result of excess of revenues over expenses of \$4,286,390 in fiscal year 2016 as reported within the statements of revenues, expenses and changes in net position, offset by a distribution to MIHS of \$3,500,000.

**Maricopa Health Plan**  
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**Management's Discussion and Analysis (continued)**

MHP performs periodic analysis of its expected future health care costs and maintenance costs to determine whether such costs will exceed anticipated future revenues under its contracts. Should expected costs exceed anticipated revenues, a premium deficiency reserve is accrued. At June 30, 2016 and 2015, MHP did not record a premium deficiency reserve.

*Federal Income Tax:* As a governmental unit or a political subdivision thereof, MIHS is exempt from federal income tax under section 115(1) of the Internal Revenue Code. MIHS is also exempt from state income taxes.

*Premium Tax:* The state of Arizona imposes a premium tax on capitation payments paid to MHP by AHCCCS. MHP receives amounts equal to the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. MHP includes the taxes collected as revenues and taxes remitted as an expense in the accompanying statements of revenues, expenses and changes in net position.

**Economic and Other Factors and Next Year's Forecast**

MHP's management considers many factors when setting the fiscal year forecast. Of primary importance is the status of the economy, which takes into account market forces and environmental factors such as the following:

- Health care reform
- Changes in revenue rates under the AHCCCS contract
- Changes in enrollment/market share under the AHCCCS contract
- Effectiveness in managing care and population health for enrolled members
- Changes in provider costs affecting MHP's total health care expenses

Enrollment at June 30, 2015, was 78,446 members and has increased by 2,841 to 81,287 members at June 30, 2016.

As all of MHP's revenues were earned under its AHCCCS contract, continuation of the AHCCCS programs is dependent on governmental policies. The current AHCCCS contract is effective through September 30, 2018. However, MIHS has notified AHCCCS that they will not continue the contract after February 1, 2017 due to the acquisition of the plan by an external party.

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Statements of Net Position

	June 30	
	2016	2015
<b>Assets</b>		
Current assets:		
Cash	\$ 57,442,403	\$ 27,635,879
Reinsurance receivable	4,328,233	3,507,042
Capitation and supplemental revenue receivable	174,589	92,408
Reconciliation receivable	989,241	2,723,772
Due from affiliate	-	31,428,586
Other current assets	944,070	478,816
Total current assets	63,878,536	65,866,503
Reconciliation receivable	4,193,986	-
Total assets	\$ 68,072,522	\$ 65,866,503
<b>Liabilities and net position</b>		
Current liabilities:		
Accounts payable	\$ 1,347,955	\$ 685,660
Accrued administrative costs	1,912,875	2,123,232
Medical claims payable	31,763,100	25,678,037
Payment reform/shared savings payable	4,818,467	1,913,622
Reconciliation payable	260,351	7,387,515
Other current liabilities	209,581	345,168
Total current liabilities	40,312,329	38,133,234
Reconciliation payable	8,297,674	9,057,140
Total liabilities	48,610,003	47,190,374
Unrestricted net position	19,462,519	18,676,129
Total liabilities and net position	\$ 68,072,522	\$ 65,866,503

*See notes to financial statements.*

**Maricopa Health Plan**  
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Statements of Revenues, Expenses and Changes in Net Position (continued)

	<b>Year Ended June 30</b>	
	<b>2016</b>	<b>2015</b>
Less:		
Reinsurance recoveries	\$ 9,653,086	\$ 7,105,346
Third-party liability, net of collection fees	<u>1,904,929</u>	<u>1,452,264</u>
Total net health care expenses	<u>270,445,556</u>	226,028,143
Administrative expenses:		
Management fees	23,432,397	21,157,297
Other	<u>177,448</u>	<u>306,172</u>
Total administrative expenses	<u>23,609,845</u>	21,463,469
Premium taxes	<u>6,305,821</u>	5,717,196
Total operating expenses	<u>300,361,222</u>	<u>253,208,808</u>
Excess of revenues over expenses	4,286,390	8,853,795
Distribution to Maricopa Integrated Health System	<u>(3,500,000)</u>	<u>(10,000,000)</u>
Increase (decrease) in unrestricted net position	786,390	(1,146,205)
Unrestricted net position, beginning	<u>18,676,129</u>	<u>19,822,334</u>
Unrestricted net position, ending	<u>\$ 19,462,519</u>	<u>\$ 18,676,129</u>

*See notes to financial statements.*

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Notes to Financial Statements

June 30, 2016

**1. Organization and Operations**

**Organizational Structure**

Maricopa Health Plan (MHP) provides health plan services to enrollees under a contract with the Arizona Health Care Cost Containment System (AHCCCS) in Maricopa County, Arizona. Effective October 1, 2005, Maricopa County Special Health Care District, d/b/a Maricopa Integrated Health System (MIHS), a statutory Special Health Care District and political subdivision of the state of Arizona, assumed the operations and financial responsibility for MHP, which was previously operated by Maricopa County. MHP is a department of MIHS. The financial statements present only MHP and do not purport to, and do not, present fairly the net position of MIHS and its changes in net position and its cash flows, in conformity with accounting principles generally accepted in the United States of America.

All of MHP's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS program is dependent upon governmental policies. This contract is subject to renewal. In March 2013, MHP was awarded a new five-year contract with AHCCCS to operate MHP through September 30, 2018. The loss of this contract would have an adverse effect on MHP's future operations. MIHS has notified AHCCCS that they will not continue the contract after February 1, 2017 due to the acquisition of the plan by an external party.

MHP has a contract with University Physicians Healthcare (UPH) to provide comprehensive management and administrative services necessary for the operation of MHP. UPH was acquired by Banner Health (Banner) on February 28, 2015, and Banner became successor to UPH in this management contract.

**2. Summary of Significant Accounting Policies**

**Basis of Accounting**

MHP provides managed care services, as defined in the American Institute of Certified Public Accountants' (AICPA) *Audit and Accounting Guide, Health Care Entities*, and follows accounting principles generally accepted in the United States of America. MHP follows applicable Governmental Accounting Standards Board (GASB) principles and prepares its financial statements on the accrual basis of accounting using the economic resources measurement focus.



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Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Reinsurance Receivable**

Reinsurance receivable represents management's estimate of the medical claim cost it has earned that will be recoverable under its reinsurance contract with AHCCCS and is calculated based on the identification of qualifying incurred inpatient and pharmacy expenses and a percentage of estimated inpatient and certain pharmaceutical costs incurred but not yet reported. As a result, there is a possibility that recorded estimates will change by a material amount in the near term. MHP recorded changes in estimate for reinsurance recoveries of approximately \$780,000 during 2016 that relate to services provided in 2015, and approximately \$46,000 during 2015 that relate to services provided in 2014, which are recorded as an increase to reinsurance recoveries on the accompanying statements of revenues, expenses and changes in net position.

**Medical Claims Payable**

The costs of hospital and medical services provided to enrollees served under contract are recognized in the period that the services are rendered. An accrual has been made for unpaid claims in process of review and for claims incurred but not reported as of June 30, 2016 and 2015. The amount of this liability is estimated by independent actuaries using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Because considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term (See Note 3). Management believes that the medical claims payable recorded is adequate as of June 30, 2016 and 2015.

**Premium Deficiency Reserve**

MHP performs periodic analysis of its expected future health care costs and maintenance costs to determine whether such costs will exceed anticipated future revenues under its contracts. Should expected costs exceed anticipated revenues, a premium deficiency reserve is recognized. Investment income is not included in the calculation of premium deficiency reserves. At June 30, 2016 and 2015, contracted rates and anticipated expenses did not warrant a premium deficiency reserve.

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Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

settlement with AHCCCS. As of June 30, 2016, AHCCCS has settled the reconciliation receivable (payable) with MHP through September 30, 2013. The estimated reconciliation receivable (payable) for contract years ending September 30, 2014, September 30, 2015 and through June 30, 2016, for the September 30, 2016 contract year, has been recorded as estimated reconciliation receivable (payable) on the statements of net position. A change in estimate of \$3,300,000 was recorded as an increase to settlement revenue for 2016.

Amounts due to (from) AHCCCS for the Adults  $\leq$  106% of the Federal Poverty Level (Adults  $\leq$  106, formerly known as TWG) reconciliation settlement represents MHP's profit or loss for these members in excess of 2% for the member population. For the contract year ended September 30, 2013, the Adults  $\leq$  106 reconciliation settlement represents MHP's profit or loss for these members in excess of 2% of capitation received for the non-medical expense population. Reconciliation settlement for Adults  $\leq$  106 expired with contract year ending September 30, 2013.

Amounts due to (from) AHCCCS for PPC reconciliation settlement represents MHP's profit or loss in excess of 2% of capitation received for the PPC members and is estimated based on AHCCCS's applicable policy. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) AHCCCS for the prospective tiered reconciliation settlement represents MHP's profit or loss for the prospective members. The tiered reconciliation settlement represents 50% of MHP's profit for these members in excess of 3% to 6% of capitation received and 100% of MHP's profit in excess of 6% of capitation received and 100% of MHP's loss in excess of 3% of capitation received. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) AHCCCS for the adults  $>$ 106 % of the Federal Poverty Level (Adults  $>$  106, formerly known as Newly Eligible Adults) reconciliation settlement represents MHP's profit or loss for the newly eligible adult members. The Adults  $>$  106 reconciliation settlement represents MHP's profit or loss for these members in excess of 1% of capitation received. Because the Adults  $>$  106 reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Maricopa Health Plan  
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Notes to Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Income Taxes**

As a governmental unit or a political subdivision thereof, MIHS is exempt from federal income tax under section 115(1) of the Internal Revenue Code. MIHS is also exempt from state income taxes. Accordingly, no provision is made for income taxes in the accompanying financial statements.

**Risk Management**

MHP is exposed to various risks of loss from torts, business interruption, errors and omissions, and natural disasters. Commercial insurance coverage is purchased by MIHS for MHP for claims arising from such matters.

MHP receives reinsurance coverage from AHCCCS to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The gross capitation rates were reduced by the reinsurance cost. Under the AHCCCS program, risk of loss for inpatient claims is generally limited to an annual deductible of \$25,000 per member, per policy year. Eligible reinsurance claims are reported in the accompanying financial statements as a reduction of health care expenses at the amount expected to be collected from AHCCCS.

**Subsequent Events**

All of the effects of subsequent events that provide additional evidence about conditions that existed at the financial statement date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. MHP does not recognize subsequent events that provide evidence about conditions that did not exist at the financial statement date but arose after, but before the financial statements are available to be issued. However, non-recognized subsequent events are disclosed. MHP has evaluated events and transactions occurring subsequent to June 30, 2016 through December 19, 2016, the date of issuance of the financial statements. During this period, there were no events requiring recognition in the financial statements. Additionally, there were no non-recognized subsequent events requiring disclosure.

**Maricopa Health Plan**  
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**Notes to Financial Statements (continued)**

**3. Medical Claims Payable (continued)**

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities at any year-end are continually reviewed and re-estimated as information regarding actual claim payments becomes known. This information is compared to the originally established year-end liability. Negative amounts reported for incurred, related to prior years, result from claims being adjudicated and paid for amounts less than originally estimated. Positive amounts reported for incurred, related to prior years, result from claims being adjudicated and paid for amounts greater than originally estimated.

**4. Related-Party Transactions**

MHP purchased hospitalization and medical compensation services from MIHS. For the years ended June 30, 2016 and 2015, MHP incurred claims from MIHS totaling approximately \$34,500,000 and \$26,600,000, respectively.

**5. Commitments and Contingencies**

**Litigation**

MHP is party to various legal actions and is subject to various claims arising in the ordinary course of business. Management believes that the disposition of these matters will not have a material adverse effect on MHP's financial position or results of operations.

**AHCCCS Performance Measures**

MHP's contract with AHCCCS requires MHP to be in compliance with certain financial and quality performance measures, as defined in the AHCCCS contract. For the contract year ended September 30, 2013, management determined that MHP did not meet certain quality AHCCCS performance measures. In response to these violations, AHCCCS may require MHP to submit corrective action plans and subject MHP to sanctions. At June 30, 2016 and 2015, MHP has recognized a liability of \$175,000 related to this contingency within other current liabilities. Due to the uncertainty of the outcome of AHCCCS' review, it is reasonably possible that recorded estimates will change by a material amount in the near term. Management believes that MHP is in compliance with these measures for contract periods ending after September 30, 2013, through June 30, 2016. Compliance with these performance measures can be subject to future review by AHCCCS and may result in sanctions unknown or unasserted at this time.

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