



AUDITED FINANCIAL STATEMENTS

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)
Year Ended September 30, 2009
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Report of Independent Auditors

The Board of Directors
Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

We have audited the accompanying balance sheet of Health Choice Arizona (the Plan), a division of Health Choice Arizona, Inc., which is a wholly owned subsidiary of IASIS Healthcare LLC, as of September 30, 2009 and the related statements of earnings, changes in equity of Parent and cash flows for the year then ended. These financial statements are the responsibility of the Plan's management. 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. We were not engaged to perform an audit of the Plan's internal control over financial reporting. Our audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Health Choice Arizona at September 30, 2009, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The details of the attached schedules of other financial information are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Ernst & Young LLP

January 25, 2010

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Balance Sheet

September 30, 2009

Assets

Current assets:

AHCCCS receivables, net	\$ 1,157,405
Due from affiliates	223,169,950
Other current assets	1,650,853
Total current assets	<u>225,978,208</u>

Furniture and equipment, net of accumulated depreciation of \$962,843	1,935,769
Other intangible assets, net of accumulated amortization of \$15,000,000	30,000,000
Goodwill	5,756,914
Total assets	<u><u>\$ 263,670,891</u></u>

Liabilities and equity of Parent

Current liabilities:

Accounts payable and accrued expenses	\$ 2,161,156
Medical claims payable	107,220,302
Total current liabilities	<u>109,381,458</u>

Equity:

Equity of Parent	154,289,433
Total liabilities and equity of Parent	<u><u>\$ 263,670,891</u></u>

See accompanying notes.

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Statement of Earnings

Year Ended September 30, 2009

Revenues:	
Capitation premiums	\$ 614,316,248
Delivery supplemental premiums	<u>43,488,073</u>
Total revenues	<u>657,804,321</u>
Medical expenses:	
Hospitalization, net	162,597,652
Medical compensation	148,883,984
Other medical, net	<u>259,983,051</u>
Total medical expenses	<u>571,464,687</u>
Administrative expenses	<u>43,276,005</u>
Total expenses	<u>614,740,692</u>
Earnings before income taxes	43,063,629
Income taxes	<u>17,034,567</u>
Net earnings	<u><u>\$ 26,029,062</u></u>

See accompanying notes.

Health Choice Arizona
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Statement of Cash Flows

Year Ended September 30, 2009

Cash flows from operating activities

Net earnings	\$ 26,029,062
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation	448,325
Amortization	3,000,000
Loss on sale of asset	151,111
Changes in operating assets and liabilities:	
AHCCCS receivables, net	29,104,012
Other current assets	(490,173)
Accounts payable and accrued expenses	302,992
Medical claims payable	17,818,292
Net cash provided by operating activities	<u>76,363,621</u>

Cash flows from investing activities

Purchases of furniture and equipment, net	<u>(845,129)</u>
Net cash used in investing activities	<u>(845,129)</u>

Cash flows from financing activities

Change in due from affiliates	<u>(80,518,492)</u>
Net cash used in financing activities	<u>(80,518,492)</u>

Change in cash and cash equivalents	(5,000,000)
Cash and cash equivalents, beginning of year	5,000,000
Cash and cash equivalents, end of year	<u>\$ —</u>

See accompanying notes.

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Notes to Financial Statements

September 30, 2009

1. Organization and Basis of Presentation

Health Choice Arizona (the Plan) is a division of Health Choice Arizona, Inc. (the Parent), which is a wholly owned subsidiary of IASIS Healthcare LLC (IASIS). IASIS is a hospital management company that also owns and operates 15 acute care hospital facilities and one behavioral health hospital facility in six states. The Plan is a prepaid Medicaid managed health plan that derives substantially all of its revenue through a contract with the Arizona Health Care Cost Containment System (AHCCCS) to provide specified healthcare services to qualified Medicaid enrollees through contracts with providers. AHCCCS is the state agency that administers Arizona's Medicaid program. The contract requires the Plan to arrange for healthcare services for enrolled Medicaid patients in exchange for fixed monthly premiums, based on negotiated per capita member rates, and supplemental payments from AHCCCS. These services are provided regardless of the actual costs incurred to provide these services. The Plan receives reinsurance and other supplemental payments from AHCCCS to cover certain costs of healthcare services that exceed certain thresholds.

Effective October 1, 2008, Health Choice began its current contract with AHCCCS, which provides for a three-year term, with AHCCCS having the option to renew for two additional one-year periods. The contract is terminable without cause on 90 days' written notice or for cause upon written notice if the Plan fails to comply with any term or condition of the contract or fails to take corrective action as required to comply with the terms of the contract. Additionally, AHCCCS can terminate the contract in the event of the unavailability of state or federal funding.

Under the contract, the Plan subcontracts with hospitals, physicians and other medical providers within Arizona and surrounding states to provide services to its enrollees in Apache, Coconino, Maricopa, Mohave, Navajo, Pima, Yuma, LaPaz and Santa Cruz counties.

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies

Due from Affiliates

Due from affiliates represents the net excess of funds transferred to the centralized cash management account of IASIS over funds transferred to or paid on behalf of the Plan. Due from affiliates balances are readily available to the Plan for settlement of the Plan's current liabilities as they become due. Generally, this balance is decreased by automatic cash transfers from the account to reimburse the Plan's bank accounts for operating expenses and to pay for fees and services provided by IASIS, including information systems services, and other operating expenses, such as payroll and insurance. Generally, the balance is increased through daily cash deposits by the Plan to the centralized cash management account of IASIS. Management fees totaling \$564,000, which represent an allocation of corporate office expenses of IASIS, were recognized during the year ended September 30, 2009, and are included within administrative expenses in the accompanying statement of earnings. Interest income is not earned on outstanding balances due from affiliates.

Furniture and Equipment

Furniture and equipment is stated at cost. The Plan uses the straight-line method of depreciation over the estimated useful lives of the respective assets, which generally range from 3 to 15 years. Depreciation expense totaling \$448,325 was recognized during the year ended September 30, 2009, and is included within administrative expenses in the accompanying statement of earnings.

Goodwill and Intangible Assets

Pursuant to accounting guidance related to goodwill and other intangible assets, goodwill is not amortized but is subject to annual impairment reviews or more often if events or circumstances indicate it may be impaired. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Plan has completed its annual impairment test for the 2009 fiscal year, which resulted in no impairment.

Intangible assets consists solely of the Plan's contract with AHCCCS and is amortized over a period of 15 years, which approximates the contract's estimated useful life, including assumed renewal periods. Amortization of intangible assets totaled \$3,000,000 for the year ended September 30, 2009, and is included in administrative expenses in the accompanying statement of earnings.

Health Choice Arizona
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Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

When events, circumstances or operating results indicate that the carrying values of certain long-lived assets and related identifiable intangible assets (excluding goodwill) that are expected to be held and used might be impaired, the Plan considers the recoverability of assets to be held and used by comparing the carrying amount of the assets to the undiscounted value of future net cash flows expected to be generated by the assets. If the assets are identified as impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets as determined by independent appraisals or estimates of discounted future cash flows.

Revenue Recognition

Capitation premiums are recognized as revenue in the month that members are entitled to healthcare services. Certain other supplemental payments, such as reimbursement of healthcare services provided to AHCCCS eligible beneficiaries prior to enrollment into the Plan (prior period coverage or PPC), are recognized as revenue as services are provided, including estimates at the end of each accounting period. Included in capitation premiums in the accompanying statement of earnings for the year ended September 30, 2009, are accruals for PPC reconciliation settlement payables totaling \$16,018,929, Title XIX Waiver Group reconciliation settlement payables totaling \$5,003,420, Social Security Disabled Income – Temporary Medical Coverage settlement payables totaling \$152,145 and Risk Factor adjustments totaling \$6,284,302. Included in the aforementioned accruals is approximately \$10,600,000 in reductions in premium revenue associated with settlements of various prior year program receivables.

Delivery supplemental premiums are payments received per newborn delivery and are intended by AHCCCS to cover the cost of maternity care for qualified pregnant women. Such premiums are billed and recognized in the month that delivery occurs.

Health Choice Arizona
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Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Medical Expenses

Monthly capitation payments to primary care physicians and other healthcare providers are expensed in the month services are contracted to be performed. Claims expense for non-capitated arrangements is accrued as services are rendered by hospitals, physicians and other healthcare providers during the year.

Medical claims payable includes claims received but not paid and an estimate of claims incurred but not reported. Incurred but not reported claims are estimated using a combination of historical claims experience (including severity and payment lag time) and other actuarial analysis including number of enrollees, age of enrollees and certain enrollee health indicators to predict the cost of healthcare services provided to enrollees during any given period. While management believes that its estimation methodology effectively captures trends in medical claims costs, actual payments could differ significantly from estimates given changes in the healthcare cost structure or adverse experience. During the year ended September 30, 2009, the Plan received independent actuary analysis resulting in a decrease to medical expenses of approximately \$15,500,000 related to estimates for prior years.

Reinsurance

Contractually, the Plan is reimbursed by AHCCCS for healthcare costs that exceed stated amounts at a rate ranging from 75% to 100% of qualified healthcare costs in excess of stated levels of up to \$50,000, depending on the case type of the member. Qualified costs must be incurred during the contract year and are the lesser of the amount paid by the Plan or the AHCCCS fee schedule. Amounts are recognized under the contract, with AHCCCS when healthcare costs exceed stated amounts as provided under the contract, including estimates of such costs at the end of each accounting period. In the event that AHCCCS is unable to honor its reinsurance commitment, the Plan may be responsible for excess costs incurred. Reinsurance recoveries totaling \$22,716,310 were recognized during the year ended September 30, 2009, and are included as a reduction of hospital medical expenses in the accompanying statement of earnings.

Health Choice Arizona
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Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Administrative Expenses

The Plan shares its property leases and employees with Health Choice Generations (HCG), another division of the Parent. Administrative costs are shared between the Plan and HCG based on the revenue earned by each plan. Except for certain costs that are specific to one plan or the other, all administrative expenses are paid by the Plan and allocated to HCG according to HCG's percentage of the total combined revenue of the Parent. Costs pertaining only to the Plan, such as premium tax, are not allocated. Costs that can be specifically identified as pertaining to HCG only, such as the HCC Life Insurance Company (HCC) reinsurance premiums and certain data processing and marketing costs, are directly charged to HCG.

Income Taxes

IASIS files consolidated Federal and state income tax returns, which include the operating results of the Plan. IASIS allocates taxes to the Plan pursuant to the asset and liability method, as if the Plan were a separate taxpayer. For balance sheet purposes, such allocations are included in due from affiliates in the accompanying balance sheet.

Fair Value of Financial Instruments

AHCCCS receivables, due from affiliates, accounts payable and accrued expenses, and medical claims payable represent financial instruments. The carrying value of these financial instruments approximates their fair market value due to the short-term nature of these instruments.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Subsequent Events Consideration

The Plan evaluated events and transactions occurring subsequent to September 30, 2009 through January 25, 2010, the date the financial statements were issued. During this period, there were no subsequent events that required recognition in the financial statements.

Health Choice Arizona
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Notes to Financial Statements (continued)

3. Transactions with Affiliates

The Plan remitted fee-for-service payments totaling \$8,570,700 during the year ended September 30, 2009, to facilities which are owned and operated by IASIS.

4. AHCCCS Receivables

The AHCCCS receivables consist of the following at September 30, 2009:

Reinsurance, net	\$ 11,116,627
Delivery supplement	896,908
Capitation receivable	2,863,521
TWG, PPC and Risk Factor reconciliation settlements	<u>(13,719,651)</u>
	<u>\$ 1,157,405</u>

5. Leases

The Plan leases its office facilities under various operating lease agreements. The following is a schedule of the future minimum lease payments required under noncancelable leases with initial or remaining terms in excess of one year at September 30, 2009:

Fiscal year:	
2010	\$ 1,228,577
2011	1,241,168
2012	1,275,565
2013	1,309,962
2014	775,849
Total	<u>\$ 5,831,121</u>

Rental expense totaled \$1,500,578 for the year ended September 30, 2009, and is included within administrative expenses in the accompanying statement of earnings.

Health Choice Arizona
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Notes to Financial Statements (continued)

6. Commitments and Contingencies

Professional, General and Other Liability Insurance

The Plan is subject to claims and lawsuits arising in the ordinary course of business, including, but not limited to, injuries arising from patient treatment and denials thereof and personal injuries. The Plan believes that its liability for damages resulting from such claims and lawsuits is adequately covered by insurance or is adequately provided for in its financial statements.

The Plan's contract with AHCCCS requires the Plan to maintain professional liability insurance, comprehensive general insurance, and automobile liability insurance coverage of at least \$1,000,000 for each occurrence. During the year ended September 30, 2009, the Plan was covered under IASIS' umbrella policy. IASIS, on behalf of the Plan, carries professional and general liability insurance, as well as workers' compensation insurance, in excess of self-insured retentions through an unrelated commercial insurance carrier in amounts that IASIS believes to be sufficient for the Plan, although some claims may exceed the scope of coverage in effect. IASIS maintains reserves for professional and general liability and workers' compensation claims. Accordingly, no reserve for liability risks are recorded on the accompanying balance sheet. The cost for the year ended September 30, 2009, totaled \$145,240 and \$110,558 for professional and general liability and workers' compensation, respectively, and is included within administrative expenses in the accompanying statement of earnings. The Plan is currently not a party to any such proceedings that, in the Plan's opinion, would have a material adverse effect on the Plan's business, financial condition or results of operations.

Employee Benefit Insurance Risks

The Plan participates in a self-insured program for health insurance and other medical benefit programs administered by IASIS. The cost of employee health and other medical benefits is allocated by IASIS based on total covered employees and dependents. The cost allocated to the Plan, net of employee premiums, totaled \$1,566,698 for the year ended September 30, 2009, and is included within administrative expenses in the accompanying statement of earnings.

Health Choice Arizona
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Notes to Financial Statements (continued)

6. Commitments and Contingencies (continued)

Performance Guarantee

If the Plan fails to effectively manage healthcare costs, these costs may exceed the premiums received by the Plan. The Plan believes the capitated premiums, together with reinsurance and other supplemental premiums, are sufficient to pay for the services the Plan is obligated to deliver. Pursuant to its contract with AHCCCS, the Plan is required annually to provide performance bonds or letters of credit, in an acceptable form, to guarantee performance of the Plan's obligations under its contract to provide and pay for the healthcare services. The amount of the performance guaranty that AHCCCS requires is generally based upon the membership in the Plan and the related capitation paid to the Plan. As of September 30, 2009, the Plan provided performance guarantees in the form of irrevocable standby letters of credit for the benefit of AHCCCS totaling \$43,204,401.

State and Federal Laws and Regulations

The Plan is subject to state and federal laws and regulations. The Centers for Medicare and Medicaid Services and AHCCCS have the right to audit the Plan to determine the Plan's compliance with such standards. The Plan is required to file periodic reports with AHCCCS and to meet certain financial viability standards. The Plan must also provide its enrollees with certain mandated benefits and must meet certain quality assurance and improvement requirements. The Plan believes it is in compliance with these AHCCCS requirements. The Plan must also comply with the electronic transactions regulations and privacy standards of the Health Insurance Portability and Accountability Act (HIPAA). The Plan believes it is in compliance with the HIPAA security standards as set forth in 45 CFR Part 164. The Plan has also complied with the requirements for health plans defined in 45 CFR Part 162.

Health Choice Arizona
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Notes to Financial Statements (continued)

6. Commitments and Contingencies (continued)

Other

On March 31, 2008, the United States District Court for the District of Arizona (the District Court) dismissed with prejudice the *qui tam* complaint against IASIS Healthcare Corporation (IAS), parent company of IASIS. The *qui tam* action sought monetary damages and civil penalties under the federal False Claims Act (FCA) and included allegations that certain business practices related to physician relationships and the medical necessity of certain procedures resulted in the submission of claims for reimbursement in violation of the FCA. The case dates back to March 2005 and became the subject of a subpoena by the Office of Inspector General (OIG) in September 2005. In August 2007, the case was unsealed and became a private lawsuit after the Department of Justice declined to intervene. The United States District Judge dismissed the case from the bench at the conclusion of oral arguments on IAS' motion to dismiss. On April 21, 2008, the court issued a written order dismissing the case with prejudice and entering formal judgment for IAS. On May 7, 2008, the *qui tam* relator's counsel filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit to appeal the District Court's dismissal of the case. On May 21, 2008, IAS filed a Notice of Cross-Appeal to the United States Court of Appeals for the Ninth Circuit from a portion of the April 21, 2008 Order and, on July 22, 2008, IAS filed a Motion to Disqualify relator's counsel related to their misappropriation of information subject to a claim of attorney-client privilege by IAS. On August 21, 2008, the court issued a written order denying IAS' Motion to Disqualify and resetting the briefing schedule associated with the Ninth Circuit appellate proceedings. On October 21, 2008, the relator filed his appeal brief with the United States Court of Appeals for the Ninth Circuit. IAS filed its cross-appeal brief on January 20, 2009. Currently, the Ninth Circuit appeal is expected to take another six to nine months to complete. If the appeal of the order dismissing the *qui tam* action with prejudice was to be resolved in a manner unfavorable to IAS, it could have a material adverse effect on the business, financial condition and results of operations of IAS and the Plan, including exclusion from the Medicare and Medicaid programs.

Health Choice Arizona
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Notes to Financial Statements (continued)

7. Retirement Plan

Substantially all employees of the Plan, upon qualification, are eligible to participate in IASIS' defined contribution 401(k) plan. Employees who elect to participate generally make contributions from 1% to 20% of their eligible compensation and IASIS matches, at its discretion, such contributions on behalf of the Plan up to a maximum percentage. Generally, employees immediately vest 100% in their own contributions and vest in the employer portion of contributions over a period not to exceed five years. Defined contribution expense totaled \$118,156 for the year ended September 30, 2009, and is included within administrative expenses in the accompanying statement of earnings.