

Maricopa Health Plan (A Contract of Maricopa Integrated Health System)

Financial Report
June 30, 2011



McGladrey

McGladrey & Pullen, LLP
Certified Public Accountants



Independent Auditor's Report

To the Board of Directors
Maricopa Health Plan (a contract of Maricopa Integrated Health System)

We have audited the accompanying statement of financial position of Maricopa Health Plan (MHP) (a contract of Maricopa Integrated Health System) as of June 30, 2011, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of MHP'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 of America. 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 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 MHP'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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note 1, MHP is a health plan of Maricopa County Special Health Care District (the District) d/b/a Maricopa Integrated Health System, a statutory Special Health Care District and political subdivision of the State of Arizona. The financial statements present only MHP and do not purport to, and do not, present fairly the financial position of the District and its changes in financial position and cash flows in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Maricopa Health Plan (a contract of Maricopa Integrated Health System) as of June 30, 2011, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Management has chosen not to present a management's discussion and analysis for MHP that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements.

McGladrey & Pullen, LLP

Minneapolis, Minnesota
October 26, 2011

Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)

Statement of Financial Position
June 30, 2011

Assets

Current Assets	
Cash and cash equivalents	\$ 35,483,544
Reinsurance receivable	7,401,239
Capitation and supplemental revenue receivable	70,259
Other current assets	<u>963,554</u>
Total current assets	43,918,596
Settlements Receivable	1,175,083
Other Assets	<u>275,794</u>
	<u>\$ 45,369,473</u>

Liabilities and Net Assets

Current Liabilities	
Accounts payable	\$ 595,809
Accrued administrative costs	958,407
Medical claims payable	24,611,077
Settlements payable	3,192,359
Other current liabilities	<u>74,875</u>
Total liabilities	29,432,527
Commitments and Contingencies	
Unrestricted Net Assets	<u>15,936,946</u>
	<u>\$ 45,369,473</u>

See Notes to Financial Statements.

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

**Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2011**

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Revenues and gains, net:	
Capitation	\$ 177,354,823
PPC capitation	33,985,181
SOBRA supplement	7,987,058
TWG settlement	(1,266,206)
PPC settlement	(3,540,270)
Investment income	594,087
Total revenues and gains, net	<u>215,114,673</u>
 Health care expenses:	
Hospitalization expenses:	
Hospital inpatient	54,912,394
PPC—hospital inpatient	18,165,309
Total hospitalization expenses	<u>73,077,703</u>
 Medical compensation:	
Primary care physician services	10,434,873
Referral physician services	29,873,827
Other professional services	1,173,280
PPC—physician services	4,327,256
Total medical compensation expenses	<u>45,809,236</u>
 Other medical expenses:	
Emergency services	15,899,366
Pharmacy	17,833,050
Lab, X-ray and medical imaging	11,500,988
Outpatient facility	10,709,909
Durable medical equipment	1,631,106
Dental	8,923,713
Transportation	5,624,475
Nursing facility, home health care	3,576,658
Physical therapy	533,811
PPC—other	5,094,128
Total other medical expenses	<u>81,327,204</u>
 Total health care expenses	<u>200,214,143</u>
 Less:	
Reinsurance	14,674,489
Third-party liability	509,427
Total net health care expenses	<u>185,030,227</u>

(Continued)

Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)

Statement of Revenues, Expenses and Changes in Net Assets (Continued)
Year Ended June 30, 2011

Administrative expenses:	
Management fees	18,573,561
Other	<u>229,234</u>
Total administrative expenses	<u>18,802,795</u>
Premium taxes	<u>4,645,989</u>
Total operating expenses	<u>208,479,011</u>
Operating gain	6,635,662
Capital distribution to Maricopa Integrated Health System	<u>(6,000,000)</u>
Increase in unrestricted net assets	635,662
Unrestricted net assets, beginning	<u>15,301,284</u>
Unrestricted net assets, ending	<u><u>\$ 15,936,946</u></u>

See Notes to Financial Statements.

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

**Statement of Cash Flows
Year Ended June 30, 2011**

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Cash Flows From Operating Activities	
Cash received for capitation and supplemental revenue receipts	\$ 222,176,901
Cash paid to providers and facilities	(201,120,490)
Cash paid for supplies, purchased services and other	(28,301,661)
Net cash used in operating activities	<u>(7,245,250)</u>
Cash Flows From Capital and Related Financing Activities	
Capital distribution to Maricopa Integrated Health System	(6,000,000)
Net cash used in capital and related financing activities	<u>(6,000,000)</u>
Net decrease in cash and cash equivalents	(13,245,250)
Cash and Cash Equivalents, beginning	48,728,794
Cash and Cash Equivalents, ending	<u>\$ 35,483,544</u>
Reconciliation of Operating Gain to Net Cash Used in Operating Activities	
Operating gain	\$ 6,635,662
Adjustments to reconcile operating gain to net cash used in operating activities:	
Changes in assets and liabilities:	
Reinsurance receivable	(1,632,836)
Capitation and supplemental revenue receivable	9,870,147
Other current assets	184,470
Settlements receivable	(1,175,083)
Other assets	1,052,508
Accounts payable	242,531
Medical claims payable	(906,347)
Settlements payable	(16,257,302)
Other current liabilities	(302,260)
Due to AHCCCS	(4,956,740)
Total adjustments	<u>(13,880,912)</u>
Net cash used in operating activities	<u>\$ (7,245,250)</u>

See Notes to Financial Statements.

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

Notes to Financial Statements

Note 1. Organization and Operations

Organizational structure: Maricopa Health Plan (MHP or the Plan) provides health plan services to enrollees under an acute care contract with the Arizona Health Care Cost Containment System (AHCCCS) in Maricopa County, Arizona. Effective October 1, 2005, Maricopa County Special Health Care District (the 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. The Plan is governed by MIHS. MIHS is an operating division of the District. MHP has a contract with University Physicians Healthcare (UPH) to provide comprehensive management and administrative services necessary for the operation of the Plan. The accompanying financial statements present the financial position and changes in net assets of the Plan only and do not include any accounts of MIHS.

All of the Plan's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS programs is dependent upon governmental policies. This contract is subject to renewal. The Plan has been awarded its AHCCCS contract renewal through September 30, 2013. The loss of this contract would have an adverse effect on the Plan's future operations.

Note 2. Summary of Significant Accounting Policies

Basis of accounting: The Plan is a health care organization 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. The Plan follows applicable Governmental Accounting Standards Board (GASB) principles and has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of estimates: The preparation of 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 amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the 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 and cash equivalents consist of cash and investments held by the Maricopa County Treasurer. Deposits with the County Treasurer are available on demand and are pooled with other County monies for investment. The County Treasurer considers all of the Plan's investments to be cash equivalents, which are represented by investments in the County's cash management pool with maturities of three months or less from the date of purchase. The carrying amount approximates fair value because of the highly liquid nature or relative short maturity of those instruments. This portion is not identified with specific investments. MHP earns interest income on its deposits included in the Maricopa County Treasurer's Pooled Investments fund.

Cash is advanced to MHP as needed to fund expenditures. Advances are deposited with various financial institutions. At times, such deposits may be in excess of the FDIC insurance limit; however, to date, MHP has not experienced any losses on such accounts.

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

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Reinsurance receivable: Reinsurance receivable represents management's best estimate and is calculated based on the identification of qualifying incurred inpatient expenses and a percentage of estimated inpatient costs incurred but not yet reported. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. MHP recorded an increase in estimated reinsurance recoveries of approximately \$1,200,000 during 2011 that relates to services provided in 2010.

Medical claims payable: The costs of hospital and medical services provided to enrollees served under contract are accrued 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 at least a possibility that recorded estimates will change by a material amount in the near term. Management believes that the medical claims payable is adequate.

Unrestricted net assets: Unrestricted net assets are net assets that do not meet the definition of restricted or invested in capital assets, net of related debt in accordance with GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and Statement No. 38, *Certain Financial Statement Note Disclosures*.

Investment income: MHP earns interest income on its deposits included in the Maricopa County Treasurer's Pooled Investments fund. MHP's investment income consists of interest of approximately \$594,000 as of June 30, 2011.

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 accrued. Investment income is not included in the calculation of premium deficiency reserves. MHP contract rates and anticipated expenses did not require a premium deficiency reserve at June 30, 2011.

Capitation revenues: Capitation revenues include premiums earned under contracts that require MHP to provide health care services to subscribers of AHCCCS for monthly capitation fees as agreed upon by MHP and AHCCCS. Amounts receivable under these contracts are recorded as capitation and supplemental revenue receivable. Capitation rates for nonreconciled risk groups are subject to adjustment based on national episodic/diagnostic risk. As such, there is at least a possibility that recorded amounts will change by a material amount in the near term. Capitation revenues are recognized as revenue in the period to which health care coverage relates.

Supplemental revenue: Supplemental revenue is recognized as revenue in the period to which the supplemental revenue relates. Delivery supplemental revenue is recognized upon the delivery of a child by a member during a prospective enrollment period assigned to MHP.

**Maricopa Health Plan
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Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Settlement revenue (expense): Amounts due to (from) the State of Arizona for prior-period coverage (PPC) settlement revenue (expense) represents MHP's profit or loss in excess of 2 percent of capitation received for the population and is estimated based upon the State's applicable policy. Because the settlement is subject to change based on claims experience, there is at least a possibility that recorded settlements will change by a material amount in the near term.

Amounts due to (from) the State of Arizona for the Title XIX Waiver Group (TWG) reconciliation represents MHP's profit or loss for these members. For the contract year ended September 30, 2011, the TWG reconciliation represents MHP's profit or loss for these members in excess of 2 percent of capitation received for the nonmedical expense deduction (nonmed) population and 3 percent for the medical expense deduction (MED) population. Because the settlement is subject to change based on claims experience, there is at least a possibility that recorded settlements will change by a material amount in the near term.

Administrative expenses: Administrative expenses are recognized monthly as incurred and consist of the management fee paid to UPH for the management of the Plan.

Premium tax: The State of Arizona imposes a premium tax on capitation payments paid to the Plan by AHCCCS. The Plan receives the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. The Plan includes the taxes collected as revenues and taxes remitted as an expense in the accompanying statement of revenues, expenses and changes in net assets.

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: The Plan is exposed to various risks of loss from torts, errors and omissions, and natural disasters. Commercial insurance is purchased by the District for claims arising from such matters.

The Plan received 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 \$20,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid by the State at 75 percent to 85 percent with no maximum annual benefit. 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 statement of financial position date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. The Plan does not recognize subsequent events that provide evidence about conditions that did not exist at the statement of financial position date but arose after, but before the financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the financial statements from being misleading.

The Plan has evaluated subsequent events through October 26, 2011, the date on which the financial statements were available to be issued.

**Maricopa Health Plan
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Notes to Financial Statements

Note 3. Medical Claims Payable

Medical claims liability consists of the following at June 30, 2011:

Claims payable or pending approval	\$ 7,557,770
Provisions for claims incurred but not yet reported	17,053,307
	<u>\$ 24,611,077</u>

The cost of health care services is recognized in the period in which care is provided and includes an estimate of the cost of services that has been incurred but not yet reported. The Plan estimates accrued claims payable based on historical claims payments and other relevant information. Unpaid claims adjustment expenses are an estimate of the cost to process the incurred but not reported claims and are included in medical claims payable. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims paid is dependent on future developments, management is of the opinion that the accrued medical claims payable is adequate.

The following is a reconciliation of the accrued claims liability for the year ended June 30, 2011:

Beginning balance	<u>\$ 25,517,424</u>
Incurred:	
Current	201,441,525
Prior	(1,227,382)
Total	<u>200,214,143</u>
Paid:	
Current	176,830,448
Prior	24,290,042
Total	<u>201,120,490</u>
Ending balance	<u>\$ 24,611,077</u>

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.

Note 4. Related-Party Transactions

MHP purchased hospitalization and medical compensation services from MIHS. During 2011, MHP paid claims to MIHS totaling approximately \$3,684,000. During 2011, MHP paid claims to Maricopa County Special Health Care District totaling approximately \$28,377,000.

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

Notes to Financial Statements

Note 5. Commitments and Contingencies

The Plan 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 the Plan's financial position or results of operations.

AHCCCS performance measures: MHP's contract with AHCCCS requires the Plan to be in compliance with certain financial and nonfinancial performance measures as defined.

For the contract year ended September 30, 2008, management has determined that the Plan did not meet certain required nonfinancial AHCCCS performance measures. In response to these violations, AHCCCS will require MHP to submit corrective action plans and may subject the Plan to sanctions of up to \$100,000 for each deficiency. At June 30, 2011, MHP has accrued \$100,000 related to this potential liability. Due to the uncertainty of the outcome of AHCCCS' review, it is at least reasonably possible that recorded estimates will change by a material amount in the near term.

For 2011, substantially all of MHP's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS programs is dependent upon governmental policies. This contract is subject to renewal. MHP has been awarded its AHCCCS contract renewal through September 30, 2012. The loss of this contract would have an adverse effect on MHP's future operations.

MIHS has secured an irrevocable letter of credit in the amount of \$14,750,000 to fulfill the performance bond requirement of the AHCCCS contract.

Contract with UPH: MHP has a management agreement with UPH through September 30, 2014, that provides for payments to UPH based on a percent of revenues (as defined) as consideration for services rendered. Management fees to UPH are classified under administrative expenses in the statement of revenues, expenses and changes in net assets.

Health care regulatory environment: The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care 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 health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that MHP is in compliance with fraud and abuse as well as the other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.