

**UNIVERSITY FAMILY CARE HEALTH PLAN  
(A CONTRACT OF UNIVERSITY PHYSICIANS  
HEALTH PLANS -  
UNIVERSITY FAMILY CARE, LLC)**

**YEARS ENDED JUNE 30, 2010 AND 2009**



BEACHFLEISCHMAN

Independent Auditors' Report

Board of Directors  
University Physicians Healthcare  
Tucson, Arizona

We have audited the accompanying statements of financial position of University Family Care Health Plan (UFC), a contract of University Physicians Health Plans - University Family Care, LLC, as of June 30, 2010 and 2009 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of UFC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards established by the AICPA Auditing Standards Board. Those standards require that we plan and perform the audits 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 UFC'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 audits provide 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 University Family Care Health Plan, a contract of University Physicians Health Plans - University Family Care, LLC, as of June 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information on pages 13 through 15 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

*BeachFleischman PC*

October 25, 2010

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**UNIVERSITY FAMILY CARE HEALTH PLAN**  
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**STATEMENTS OF FINANCIAL POSITION**

**JUNE 30, 2010 AND 2009**

**ASSETS**

	<u>2010</u>	<u>2009</u>
<b>Current assets:</b>		
Reinsurance receivable	\$ 8,834,498	\$ 11,725,732
Due from AHCCCS	-	348,876
Capitation and supplemental revenues receivable	11,673,433	2,041,222
Due from affiliate	33,441,171	34,933,076
Other current assets	<u>1,375,491</u>	<u>782,622</u>
Total current assets	<u>55,324,593</u>	<u>49,831,528</u>
<b>Long term assets:</b>		
Settlements receivable	-	6,005
Other assets	<u>428,461</u>	<u>560,296</u>
Total long term assets	<u>428,461</u>	<u>566,301</u>
<b>Property and equipment:</b>		
Furniture and equipment	11,062	31,482
Accumulated depreciation	<u>(11,062)</u>	<u>(31,482)</u>
Property and equipment, net	<u>-</u>	<u>-</u>
	<u>\$ 55,753,054</u>	<u>\$ 50,397,829</u>

**LIABILITIES AND NET ASSETS**

<b>Current liabilities:</b>		
Accounts payable	\$ 2,568,817	\$ 1,112,702
Medical claims payable	31,444,313	38,293,336
Settlements payable, current portion	5,028,698	-
Other current liabilities	<u>395,959</u>	<u>190,589</u>
Total current liabilities	39,437,787	39,596,627
Settlements payable, net of current portion	<u>1,257,174</u>	<u>-</u>
Total liabilities	40,694,961	39,596,627
Commitments and contingencies		
Unrestricted net assets	<u>15,058,093</u>	<u>10,801,202</u>
	<u>\$ 55,753,054</u>	<u>\$ 50,397,829</u>

See notes to financial statements.

**UNIVERSITY FAMILY CARE HEALTH PLAN**  
**(A CONTRACT OF UNIVERSITY PHYSICIANS HEALTH PLANS - UNIVERSITY FAMILY CARE, LLC)**

**STATEMENTS OF ACTIVITIES**

**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Revenues, net:		
Capitation	\$226,485,600	\$143,545,191
PPC capitation	30,912,569	27,606,967
Hospital supplement	-	462,243
Delivery supplement	13,042,229	8,220,437
HIV-AIDS supplement	-	25,245
TWG settlement	95,068	(400,334)
PPC settlement	(7,046,022)	406,996
Other income	-	(8,589)
Total revenues, net	<u>263,489,444</u>	<u>179,858,156</u>
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	65,618,507	40,767,117
PPC - hospital inpatient	<u>13,071,322</u>	<u>15,867,511</u>
Total hospitalization expenses	<u>78,689,829</u>	<u>56,634,628</u>
Medical compensation:		
Primary care physician services	14,957,586	9,975,344
Referral physician services	40,242,788	25,274,792
Other professional services	1,107,098	998,552
PPC - physician services	<u>2,579,372</u>	<u>4,147,724</u>
Total medical compensation expenses	<u>58,886,844</u>	<u>40,396,412</u>
Other medical expenses:		
Emergency facility services	22,867,435	13,566,815
Pharmacy	33,458,803	23,281,443
Lab, X-ray and medical imaging	16,846,450	9,857,299
Outpatient facility	14,724,754	9,862,250
Durable medical equipment	2,197,884	1,730,577
Dental	9,989,742	6,530,074
Transportation	11,861,968	8,394,145
Nursing facility, home health care	3,259,400	3,087,152
Physical therapy	2,408,955	1,442,961
Miscellaneous medical expenses	2,057	(24,786)
PPC - other	<u>4,737,076</u>	<u>5,361,010</u>
Total other medical expenses	<u>122,354,524</u>	<u>83,088,940</u>
Total health care expenses	<u>259,931,197</u>	<u>180,119,980</u>

See notes to financial statements.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**STATEMENTS OF ACTIVITIES (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Total health care expenses (continued):		
Less:		
Reinsurance	\$ 22,841,324	\$ 15,621,998
Third party liability	<u>448,874</u>	<u>14,160</u>
Total net health care expenses	<u>236,640,999</u>	<u>164,483,822</u>
Administrative expenses:		
Compensation	8,554,205	7,397,101
Data processing	1,303,663	672,847
Management fees	2,680,078	1,305,691
Interest	31,785	26,141
Occupancy	665,251	197,793
Depreciation	288,250	137,891
Marketing	99,084	131,895
Other	<u>3,577,327</u>	<u>2,402,646</u>
Total administrative expenses	<u>17,199,643</u>	<u>12,272,005</u>
Premium taxes	<u>5,891,911</u>	<u>3,930,730</u>
Total expenses	<u>259,732,553</u>	<u>180,686,557</u>
Increase (decrease) in unrestricted net assets before capital contribution	3,756,891	(828,401)
Capital contribution from University Physicians Healthcare	<u>500,000</u>	<u>3,000,000</u>
Increase in unrestricted net assets	4,256,891	2,171,599
Unrestricted net assets, beginning	<u>10,801,202</u>	<u>8,629,603</u>
Unrestricted net assets, ending	<u>\$ 15,058,093</u>	<u>\$ 10,801,202</u>

See notes to financial statements.

**UNIVERSITY FAMILY CARE HEALTH PLAN**  
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**STATEMENTS OF CASH FLOWS**

**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Increase (decrease) in unrestricted net assets before capital contribution	\$ 3,756,891	\$ (828,401)
Adjustments to reconcile increase (decrease) in unrestricted net assets before capital contribution to net cash used in operating activities:		
Changes in operating assets and liabilities:		
Reinsurance receivable	2,891,234	(8,736,463)
Due from AHCCCS	348,876	(348,876)
Capitation and supplemental revenues receivable	(9,632,211)	(1,949,500)
Due from affiliate	1,491,905	(26,231,546)
Other current assets	(592,869)	(559,199)
Settlements receivable	6,005	17,112
Other assets	131,835	64,044
Accounts payable	1,456,115	866,724
Medical claims payable	(6,849,023)	34,529,946
Settlements payable	6,285,872	-
Other current liabilities	205,370	176,159
Total adjustments	<u>(4,256,891)</u>	<u>(2,171,599)</u>
Net cash used in operating activities	<u>(500,000)</u>	<u>(3,000,000)</u>
Cash flows from financing activities:		
Capital contribution from University Physicians Healthcare	<u>500,000</u>	<u>3,000,000</u>
Net cash provided by financing activities	<u>500,000</u>	<u>3,000,000</u>
Net change in cash and cash equivalents	-	-
Cash and cash equivalents, beginning	-	-
Cash and cash equivalents, ending	<u>\$ -</u>	<u>\$ -</u>

See notes to financial statements.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS**

**YEARS ENDED JUNE 30, 2010 AND 2009**

1. Description of business and summary of significant accounting policies:

Organizational structure:

University Family Care Health Plan (UFC or the Plan) provides health plan services to enrollees under an acute care contract with the Arizona Health Care Cost Containment System (AHCCCS) in various counties in southern Arizona. Formerly operated by a division of University Physicians Healthcare (UPH), UFC was reorganized in October 2008 as a single-member Arizona limited liability company of UPH, University Physicians Health Plans - University Family Care, LLC (UPHP-UFC, LLC). As a limited liability company, the members' liability is limited. UPHP-UFC, LLC was formed to operate the University Family Care Health Plan. The accompanying financial statements present the financial position and changes in net assets of the Plan only as of and for the years ended June 30, 2010 and 2009, and do not represent the financial position and changes in net assets of UPHP-UFC, LLC.

*New* Accounting standards:

During 2010, the Financial Accounting Standards Board (FASB) Accounting Standards Codification (the Codification or ASC) became effective and superseded prior existing financial accounting standards and is now the single source of authoritative U.S. generally accepted accounting principles (GAAP). The Codification does not change previous GAAP and, accordingly, its adoption did not have a material impact on UFC's financial statements.

Use of estimates:

The preparation of financial statements in conformity with GAAP 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.

Capitation premiums:

Capitation premiums include revenue earned under contracts that require UFC to provide health care services to subscribers of AHCCCS for monthly capitation fees as agreed upon by UFC and AHCCCS. Amounts receivable under these contracts are recorded as capitation and supplemental revenue receivable. Capitation rates for non-reconciled 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.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

1. Description of business and summary of significant accounting policies (continued):

Supplemental revenues:

Hospital and HIV-AIDS supplemental revenues are recognized when a member is identified as being eligible for these supplemental programs. Delivery supplemental revenue is recognized upon the delivery of a child by a member during a prospective enrollment period assigned to UFC. This supplemental payment does not include payment for deliveries of those members who deliver in a prior period coverage time period, or for Social Security Disability Insurance - Temporary Medical Coverage (SSDI-TMC) members or State Only Transplant members. The hospital and HIV supplemental revenues were discontinued by AHCCCS effective October 1, 2008.

Settlement revenue (expense):

Amounts due to (from) the State of Arizona for prior period coverage reconciliation (PPC) revenue (expense) represents UFC's profit or loss in excess of 2% 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. UFC recorded a reduction in settlement revenue of approximately \$6,200,000 related to AHCCCS' determination that the PPC capitation rates became actuarially unsound due to unexpected growth of the PPC population in comparison to the related medical experience.

Amounts due to (from) the State of Arizona for the Title XIX Waiver Group (TWG) reconciliation, represents UFC's profit or loss for these members in excess of 3% for the population through September 30, 2009. For contract year end September 30, 2010, the TWG reconciliation represents UFC's profit or loss for these members in excess of 2% for the non-medical expense deduction (non-MED) population and 3% 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.

Property and equipment:

Only property and equipment used solely for the operations of UFC's AHCCCS plan are reported on the UFC financial statements. UFC is allocated a portion of depreciation expense for the shared use of any other property and equipment.

Cash and cash equivalents:

UPH maintains all cash and cash equivalents generated by UFC. Therefore, there are no cash and cash equivalents presented in the accompanying statement of financial position. As a result, UPH assumes any credit risk associated with UFC.

UPH places its cash and cash equivalents with various credit institutions. At times, such investments may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

1. Description of business and summary of significant accounting policies (continued):

Reinsurance:

UFC received insurance 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 at 75% to 85% 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. 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. UFC recorded an increase in estimated reinsurance recoveries of approximately \$951,000 during 2010 that relates to services provided in 2009.

Medical claims payable:

The cost 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 received 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. UFC recorded a decrease in estimated hospital and medical expenses of approximately \$4,613,000 and \$465,000 during 2010 and 2009 representing a change in the estimate of medical claims payable.

Administrative expenses:

Administrative expenses are recognized monthly as incurred and consist of administrative expenses that directly relate to the AHCCCS program as well as an allocation for general administrative expenses.

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 statements of activities.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

1. Description of business and summary of significant accounting policies (continued):

**Income taxes:**

UPHP-UFC, LLC is a single-member limited liability company and, as such, is a disregarded entity for income tax purposes. All activity of UPHP-UFC, LLC is reported on the tax returns of UPH. UPH has been recognized as a tax-exempt organization for federal income tax purposes under Section 501(c)(3) of the Internal Revenue Code. UPH has also been recognized as a tax-exempt organization for state income tax purposes. Accordingly, no income taxes are provided in the accompanying financial statements.

Effective July 1, 2009, UPH was required to adopt the revised provisions of ASC 740, relating to uncertain income tax positions. These standards require management to perform an evaluation of all income tax positions taken or expected to be taken in the course of preparing the Plan's income tax returns to determine whether the income tax positions meet a "more likely than not" standard of being sustained under examination by the applicable taxing authorities. This evaluation is required to be performed for all open tax years, as defined by the various statutes of limitations, for federal and state purposes.

UPH is only subject to income taxes on unrelated business taxable income (UBTI). As a result, UPH is required to file informational returns for federal and state purposes and, if it has UBTI, federal and state income tax returns. With limited exceptions, UPH is no longer subject to tax examination for any years earlier than 2006 for federal and 2005 for state. Management has performed its evaluation of tax positions taken on all open tax returns and has determined that there were no positions taken that do not meet the "more likely than not" standard.

From time to time, UPH may be subject to penalties assessed by various taxing authorities, which are classified as general and administrative expenses when they occur.

**Subsequent events:**

UFC's management has evaluated the events that have occurred subsequent to June 30, 2010 through October 25, 2010, the date that the financial statements were available to be issued.

During 2010, the Arizona Board of Regents (ABOR) formed UA Healthcare, Inc. (UAH), an Arizona nonprofit corporation. UAH was formed to facilitate the integration of UPH and University Medical Center Corporation (UMCC) effective July 1, 2010. Accordingly, UPH and UMCC amended their articles of incorporation in July 2010 to provide for UAH as their sole corporate member. ABOR is responsible for the appointment and removal of members of the board of directors of UAH.

Management has determined no events other than those discussed in the preceding paragraph have occurred during this period that require adjustment to or disclosure in the financial statements. Management has no responsibility to update these financial statements for events and circumstances occurring after this date.

Section  
Added  
2010

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

2. Due from AHCCCS:

Beginning with the contract year ended September 30, 2009, AHCCCS implemented a national episodic/diagnostic risk adjustment model to adjust the capitation rates for non-reconciled risk groups. No amounts have been recorded related to the model at June 30, 2010 for the contract year ended September 30, 2010. At June 30, 2009, UFC recorded a receivable due from AHCCCS for \$348,876 related to contract year ended September 30, 2009. The actual 2009 capitation adjustment was \$442,531. Therefore, included in 2010 capitation revenue is \$93,655 related to the 2009 contract year.

3. Commitments and contingencies:

AHCCCS performance measures:

UFC's contract with AHCCCS requires the Plan be in compliance with certain financial and nonfinancial performance measures as defined. At June 30, 2010, UFC was in compliance with these financial performance measures. For the contract year ended September 30, 2008, management has determined that the Plan did not maintain AHCCCS nonfinancial performance standards in seven categories. In response to these violations, AHCCCS may require UFC to submit a corrective action plan to cure the violations and may subject the Plan to sanctions of up to \$100,000 for each deficiency. At June 30, 2010, UFC has accrued \$100,000 related to this potential liability. Due to the uncertainty of the outcome of AHCCCS' review, it is at least reasonably possibly that recorded estimates will change by a material amount in the near term.

*Also  
Added*

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

Performance bond:

UPH secured an annual performance bond on behalf of UFC in the amount of \$20,188,457 with Fidelity and Deposit Company of Maryland and Zurich American Insurance Company to satisfy the performance bond requirement of UFC's AHCCCS contract. UPH provided \$7,000,000 in cash as collateral for this bond. The bond satisfies UFC's contractual obligation as prescribed by AHCCCS.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

3. Commitments and contingencies (continued):

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 UFC is in compliance with fraud and abuse as well as 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.

4. Related party transactions:

UFC purchased physician services for its members from University Physicians Practice Plan (University Physicians) and hospital based healthcare services from University Physicians Healthcare Hospital at Kino Campus (UPHH) and UMCC.

At June 30, 2010 and 2009, UFC had a receivable totaling \$33,441,171 and \$34,933,076 due from UPH that represents UFC's allocation of cash and cash equivalents.

During 2010 and 2009, UFC paid claims for medical expenses to University Physicians totaling \$10,584,211 and \$7,070,932, UPHH totaling \$7,036,810 and \$4,176,958 and UMCC totaling \$32,293,221 and \$15,198,287.

During 2010, UPH contributed \$500,000 to UFC to satisfy the AHCCCS minimum equity requirements. During 2009, UPH contributed \$3,000,000 to UFC to satisfy the AHCCCS equity requirements to begin operations in the counties of Santa Cruz, Pinal, Gila, Cochise, Graham and Greenlee.

**UNIVERSITY FAMILY CARE HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2010 AND 2009**

5. Functional expenses:

UFC provides health care services to residents within its geographic locations. UFC incurs general and administrative expenses for various activities, including management and administrative activities, which support the provision of health care services. A summary of expenses related to providing these services for the years ended June 30 are as follows:

	<u>2010</u>	<u>2009</u>
Health care services	\$251,002,412	\$174,425,607
Supporting services	<u>8,730,141</u>	<u>6,260,950</u>
	<u>\$259,732,553</u>	<u>\$180,686,557</u>