HEALTH NET ACCESS, INC.

FINANCIAL STATEMENTS

Years Ended December 31, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholder of:

Health Net Access, Inc.

We have audited the accompanying financial statements of ***Health Net Access, Inc.*** (the Company), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of comprehensive (loss) income, stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ***Health Net Access, Inc.*** as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mayer Hoffman McCann P.C.

April 27, 2018

HEALTH NET ACCESS, INC.

BALANCE SHEETS

December 31, 2017 and 2016

ASSETS

	2017	2016
CURRENT ASSETS		
Cash and cash equivalents	$ 12,779,606	$ 68,592,911
Capitation and supplement receivables	172,751	902,418
Health insurer fee receivable	-	6,174,135
Reinsurance receivables	2,554,900	1,980,390
Provider receivables, net of allowance of $0 and $174,618	175,506	1,618,685
Pharmaceutical rebates receivable	470,810	539,775
Income taxes receivable from affiliate	7,099,468	20,648,245
Short-term investments	2,631,689	-
Prepaid expenses and other current assets	915,217	1,402,568
Due from affiliates	2,047,634	3,307,114
TOTAL CURRENT ASSETS	28,847,581	105,166,241
LONG-TERM INVESTMENTS	32,004,397	-
RECONCILIATION RECEIVABLES	13,169,635	-
DEFERRED INCOME TAX ASSET, net	772,052	219,170
PROVIDER RECEIVABLES	-	285,554
TOTAL ASSETS	$ 74,793,665	$ 105,670,965

LIABILITIES AND STOCKHOLDER'S EQUITY

CURRENT LIABILITIES		
Medical claims payable	$ 32,065,867	$ 21,426,718
Reconciliation payable	1,933,252	29,276,999
Risk adjustment payable	7,233,209	-
Due to affiliates	-	1,440,274
Other current liabilities	1,029,597	2,750,635
TOTAL CURRENT LIABILITIES	42,261,925	54,894,626
RECONCILIATION PAYABLE	-	297,928
UNRECOGNIZED TAX BENEFIT LIABILITY	243,111	100,604
ALTERNATIVE PAYMENT MODEL LIABILITY	5,749,033	3,506,848
TOTAL LIABILITIES	48,254,069	58,800,006
STOCKHOLDER'S EQUITY		
Common stock (no par value, 100 shares authorized, issued and outstanding) at December 31, 2017 and 2016	-	-
Additional paid-in capital	59,500,000	69,500,000
Accumulated other comprehensive loss	(48,197)	-
Accumulated deficit	(32,912,207)	(22,629,041)
TOTAL STOCKHOLDER'S EQUITY	26,539,596	46,870,959
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	$ 74,793,665	$ 105,670,965

See Notes to Financial Statements

HEALTH NET ACCESS, INC.

STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

Years Ended December 31, 2017 and 2016

	2017	2016
REVENUES		
Health services premiums:		
Capitation premiums	$ 224,744,215	$ 214,524,486
Delivery supplement	8,189,159	8,128,011
Health insurer fee revenue	-	6,174,135
Total health services premiums	232,933,374	228,826,632
Investment and other income	467,056	1,320
TOTAL REVENUES	233,400,430	228,827,952
EXPENSES		
Health care services:		
Hospitalization	52,185,557	33,684,778
Medical compensation	60,725,010	52,325,956
Other medical	117,421,379	116,217,084
Decrease in premium deficiency reserve	-	(22,824,020)
Less reinsurance	(8,756,738)	(5,890,803)
Less third party liability	(428,452)	(625,911)
Total health care services, net of reinsurance and third party liability	221,146,756	172,887,084
Premium tax	4,054,502	4,694,736
Health insurer fee	-	3,932,924
Administrative	23,518,954	22,153,271
Interest	269,259	121,341
TOTAL EXPENSES	248,989,471	203,789,356
NET (LOSS) INCOME BEFORE INCOME TAXES	(15,589,041)	25,038,596
INCOME TAX (BENEFIT) EXPENSE	(5,305,875)	10,239,144
NET (LOSS) INCOME	(10,283,166)	14,799,452
OTHER COMPREHENSIVE LOSS		
Unrealized losses on available-for-sale investments, net of tax	(48,197)	-
TOTAL COMPREHENSIVE (LOSS) INCOME	$ (10,331,363)	$ 14,799,452

See Notes to Financial Statements

HEALTH NET ACCESS, INC.

STATEMENTS OF STOCKHOLDER'S EQUITY

Years Ended December 31, 2017 and 2016

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholder's Equity
Balance at December 31, 2015	-	$ 54,500,000	$ (37,428,493)	$ -	$ 17,071,507
Net income	-	-	14,799,452	-	14,799,452
Contribution from Parent	-	15,000,000	-	-	15,000,000
Balance at December 31, 2016	-	69,500,000	(22,629,041)	-	46,870,959
Net loss	-	-	(10,283,166)	-	(10,283,166)
Unrealized losses on available-for - sale investments, net of tax	-	-	-	(48,197)	(48,197)
Distribution to Parent	-	(10,000,000)	-	-	(10,000,000)
Balance at December 31, 2017	-	$ 59,500,000	$ (32,912,207)	$ (48,197)	$ 26,539,596

See Notes to Financial Statements

HEALTH NET ACCESS, INC.

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (10,283,166)	$ 14,799,452
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Deferred federal income taxes	(552,882)	7,980,698
Change in assets and liabilities:		
Capitation and supplement receivables	729,667	(6,365,008)
Health insurer fee receivable	6,174,135	-
Reinsurance receivables	(574,510)	289,267
Reconciliation receivables and payables	(40,811,310)	(20,208,635)
Provider receivables	1,728,733	(907,555)
Pharmaceutical rebates receivable	68,965	93,774
Income taxes receivable from affiliate	13,548,777	(13,585,829)
Prepaid expenses and other current assets	487,351	(227,139)
Due to/from affiliates	(180,794)	1,490,054
Medical claims payable	10,639,149	(1,991,966)
Premium deficiency reserve	-	(22,824,020)
Risk adjustment payable	7,233,209	-
Income taxes payable to affiliate	-	-
Unrecognized tax benefit liability	142,507	(17,403)
Other current liabilities	(1,721,038)	77,213
Alternative payment model liability	2,242,185	1,251,958
Net cash used in operating activities	(11,129,022)	(40,145,139)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investments	159,813,575	-
Purchases of investments	(194,497,858)	-
Net cash used in investing activities	(34,684,283)	-
CASH FLOWS FROM FINANCING ACTIVITIES:		
Contribution from Parent	-	15,000,000
Distribution to Parent	(10,000,000)	-
Net cash (used in) provided by financing activities	(10,000,000)	15,000,000
NET CHANGE IN CASH AND CASH EQUIVALENTS	(55,813,305)	(25,145,139)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	68,592,911	93,738,050
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 12,779,606	$ 68,592,911
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Income taxes paid to affiliate	$ -	$ 14,920,061
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES		
Unrealized loss on available-for-sale investments, net of tax	$ (48,197)	$ -

See Notes to Financial Statements

(1) Company, operations, and significant accounting policies

Nature of operations - Health Net Access, Inc. (the "Company" or the "Plan") was incorporated in Arizona on April 23, 2013, and commenced operations on October 1, 2013. The Company is a wholly owned subsidiary of Health Net, Inc. ("HNI" or "Parent"). On March 24, 2016, HNI was acquired by Centene Corporation ("Centene") and the Company became an indirect wholly owned subsidiary of Centene. There were no changes to the capitalization structure of the Company as a result of the acquisition.

The Company is regulated by the Arizona Health Care Cost Containment System ("AHCCCS"), Arizona's Medicaid program. AHCCCS is approved by the Secretary of Health and Human Services and the Centers for Medicare and Medicaid Services, as a Section 1115 of the Social Security Act, Waiver Demonstration Program, which gives Arizona additional flexibility to design and improve its program, while still receiving Federal Medicaid expenditures.

Effective October 1, 2013, the Company became a contractor for AHCCCS, by entering into a prepaid capitated contract, pursuant to Arizona Revised Statutes Title 36 Chapter 29, and thereby started to administer acute health care services to qualified Medicaid members in Maricopa County, Arizona, in accordance with AHCCCS statute and rules, and federal law and regulations. The Plan's current contract with AHCCCS expires September 30, 2018.

On November 2, 2017, AHCCCS released the AHCCCS Complete Care Request for Proposal ("RFP") which will integrate physical and behavioral health care contracts under managed care plans for the majority of the 1.5 million AHCCCS members. The integrated delivery model will offer a more cohesive health care system for members incentivizing quality health care outcomes with value based purchasing, and leverage health information technology for improved care coordination. Additionally, integrating physical health and behavioral healthcare contracts will drive strategic, innovative health care initiatives forward. The Company submitted a bid as an integrated plan in response to the RFP on January 24, 2018. In March 2018, the Company was selected to provide physical and behavioral healthcare services through the AHCCCS Complete Care program in the Central region and the Southern region. Pending regulatory approval and successful completion of readiness review, the three-year agreement, with the possibility of two two-year extensions, is expected to commence on October 1, 2018.

The Financial Accounting Standards Board ("FASB") sets accounting principles generally accepted in the United States of America ("GAAP") to ensure consistent reporting. References to GAAP are to the FASB Accounting Standards Codification ("FASB ASC").

The significant accounting policies followed by the Company are as follows:

Basis of presentation - The accompanying financial statements are prepared in accordance with FASB ASC 954-205, *Health Care Entities – Presentation of Financial Statements*.

Management's use of estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Material estimates particularly susceptible to change in the near term include revenue recognition (including the reconciliation settlements described below), health care service costs, including the medical claims payable and the premium deficiency reserve, and income taxes.

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

Cash and cash equivalents - Cash includes cash deposits in banks and cash equivalents. Cash equivalents include all highly liquid investments with maturities of three months or less when purchased. Accounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation ("FDIC").

Health services premiums - Health services premiums include the following amounts:

Prospective Capitation - Prospective capitation premiums are based on multi-year contracts with AHCCCS to provide care to Medicaid recipients.

Prior Period Coverage ("PPC") Capitation - PPC capitation premiums cover eligible health care costs of members related to the period prior to their enrollment in the Plan. Such premiums are recognized upon receipt.

Delivery Supplement - Delivery supplement premiums are intended to cover the costs of maternity care for deliveries during the prospective enrollment period. Such premiums are recognized in the period the delivery occurs.

Reconciliation Settlements - AHCCCS has risk sharing programs which include reconciliation settlements, which impact health services premiums, and are due to, or from, AHCCCS, based on predetermined profit/(loss) thresholds before income tax. If the profit or loss is less than or equal to 3% of the prospective capitation revenues, then the Company's share is 100%. If the profit is between 3% and 6%, then the Company's share is 50% of the amount over 3%, for a maximum of 4.5% of total profits. If the profit is over 6%, then the Company's share of the profits over 6% is 0%, for a maximum share of 4.5% of total profits. If the losses are in excess of 3%, then the Company's share over 3% of the losses is 0%, for a maximum share of 3% of total losses. Separate reconciliations are performed for regular prospective members, PPC members, and for membership of adults above 106% of the federal poverty level. PPC and the population of those adults over 106% of the federal poverty level are subject to different profit and loss corridors than described above (2% and 1% risk corridors, respectively, instead of 3%, and other differences). In addition, AHCCCS risk-adjusts future prospective capitation revenue to reflect the acuity of the Company's membership population.

Revenue is recognized in the month in which the related enrollees are entitled to health care services. All of the Company's revenue is earned in Arizona from its Medicaid contract with AHCCCS.

Estimated reconciliation settlement balances are recorded as a net receivable or payable on the balance sheets by risk population. A summary of the balances as of December 31, 2017 and 2016 for all open contract years is as follows. It is expected that a final settlement with AHCCCS will not be reached until over a year after the end of the specific contract year.

	2017		2016	
	Reconciliation Receivable	Reconciliation Payable	Reconciliation Receivable	Reconciliation Payable
Prospective	$ 8,959,544	$ -	$ -	$ 24,406,121
Prior period coverage	2,944,758	1,933,252	-	3,087,250
Over 106% of poverty level	1,265,333	-	-	2,081,556
Total	13,169,635	1,933,252	-	29,574,927
Less current portion	-	1,933,252	-	(29,276,999)
Non-current portion	$ 13,169,635	$ -	$ -	$ 297,928

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

Health care services - The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services that have been incurred but not yet reported. Such costs include payments to primary care physicians, specialists, hospitals, outpatient care facilities, pharmaceuticals, and other medical services and the costs associated with managing the extent of such care. The Company's health care costs can also include, from time to time, remediation of certain claims as a result of periodic reviews by various regulatory agencies. The Company estimates the amount of the provision for health care service costs incurred but not reported and the unpaid loss adjustment expenses using standard actuarial methodologies based upon historical data, including the period between the date services are rendered and the date claims are received and paid, denied claim activity, expected medical cost inflation, seasonality patterns, and changes in membership. The estimates for service costs incurred but not reported are made on an accrual basis and adjusted in future periods as required. Any adjustments to the prior period estimates are included in the current period. 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 amounts of claims and losses paid are dependent on future developments, management is of the opinion that the recorded medical claims payable is adequate to cover such costs.

The Company contracts with various providers, including medical groups, to provide professional care to certain of its enrollees on a capitated or fixed fee per member per month basis. Additionally, the Company also contracts with hospitals, physicians, and other providers of health care, pursuant to discounted fee-for-service arrangements, hospital per diem arrangements, and case rate arrangements, under which providers bill the Company for each individual service provided to enrollees.

Amounts incurred related to prior periods represents the change in medical claims payable attributable to the difference between the original estimate of incurred claims for prior periods and the revised estimate. In developing the revised estimate, there have been no changes in the approach used to determine the key actuarial assumptions, which are the completion factor and medical cost trend. Medical claims payable are estimated under actuarial standards of practice and GAAP. The majority of the medical claims payable balance held at each year-end is associated with the most recent months' incurred services because these are the services for which the fewest claims have been paid. The degree of uncertainty in the estimates of incurred claims is greater for the most recent months' incurred services. Revised estimates for prior periods are determined in each month based on the most recent updates of paid claims for prior periods.

As of December 31, 2017 and 2016, amounts incurred related to prior periods were estimated to be higher (lower) than originally estimated by approximately $1,801,000 and $(7,792,000), respectively. The majority of these amounts were due to adjustments to the medical claims payable that related to variables and uncertainties associated with the Company's assumptions.

Premium deficiency reserve - The Company assesses the profitability of contracts for providing health care services when operating results or forecasts indicate probable future losses. Contracts are grouped in a manner consistent with the method of determining premium rates. Losses are determined by comparing anticipated premiums to the total of estimated health care related costs, less reinsurance recoveries, if any, and the cost of maintaining the contracts. Losses, if any, would be recognized in the period the loss is determined and classified as health care services expenses. As of December 31, 2017 and 2016, the Company did not report a premium deficiency reserve. During the year ended December 31, 2016, the Company reversed the full premium deficiency reserve recorded as of December 31, 2015, resulting in a reduction of health care services of approximately $22,824,000. The net loss of 2017 is primarily attributed to the Medicaid Risk Adjustment initiative of AHCCCS in 2017 as disclosed below.

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

Reinsurance - AHCCCS provides a stop-loss reinsurance program for the Company for partial reimbursement of reinsurable covered medical services incurred for members. The program includes a deductible, which varies based on the Company's enrollment and the eligibility category of the members. AHCCCS reimburses the Company based on a coinsurance amount for reinsurable covered services incurred above the deductible. Coinsurance percentages vary by nature of the claim for Medicare claims. Reinsurance is stated at the actual and estimated amounts due to the Company pursuant to the AHCCCS Acute contract. Reinsurance under the AHCCCS Acute contract is subject to a $25,000 deductible and 75% coinsurance for the years ended December 31, 2017 and 2016.

To be eligible for reinsurance billing, qualified healthcare expenses must be incurred during the contract year. Reinsurance is recorded based on actual billed reinsurance claims and expected reinsurance for claims not yet paid. Reinsurance is subject to review by AHCCCS, and as a result, there is at least a reasonable possibility that recorded reinsurance will change by a material amount in the near future.

Reinsurance receivables represent the expected payment from AHCCCS to the Company for certain enrollees whose qualifying medical expenses paid by the Company were in excess of specified deductible limits. Reinsurance receivables are stated at the amount management expects to collect. Balances that are still outstanding after management has used reasonable collection efforts are written off. Management considers reinsurance receivables to be fully collectible as of December 31, 2017 and 2016 and, accordingly, an allowance for doubtful accounts is not considered necessary.

Pharmaceutical rebates receivable - The Company receives rebates from its pharmacy benefit manager based on the volume of drugs purchased. The Company records a receivable and a reduction of other medical expenses for estimated rebates due based on purchase information. Pharmaceutical rebates totaled approximately $957,000 and $923,000 for the years ended December 31, 2017 and 2016, respectively, which are included as reductions in other medical expenses in the accompanying statements of comprehensive (loss) income. As of December 31, 2017 and 2016, management believes the pharmaceutical rebate receivable balances are fully collectible and accordingly, an allowance has not been established.

Provider receivables - In the normal course of business, provider receivables are created through claims overpayments. Amounts due from providers are expected to be collected within one year. Provider receivables are stated at the amount management expects to collect. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to earnings and a credit to provider receivables. As of December 31, 2017 and 2016, management has recorded an allowance for doubtful provider receivables of approximately $0 and $175,000, respectively.

Investments - Investments as of December 31, 2017 are classified, and accounted for, as available-for-sale investments. Government, corporate and asset-backed bonds, notes, and certificates are classified as available-for-sale when the Company anticipates that the securities could be sold in response to rate changes, prepayment risk, liquidity, availability of and the yield on alternative investments, and other market and economic factors. Unrealized gains and losses on available-for-sale investments are recognized as direct increases or decreases in other comprehensive (loss) income. For the year ended December 31, 2017, the Company recognized approximately $48,000 of unrealized losses, net of tax effect, on available-for-sale investments which has been recorded in the accompanying statement of comprehensive (loss) income. Cost of investments sold is recognized using the specific identification method. The Company did not have available-for-sale investments as of or during the year ended December 31, 2016.

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

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

Investments that experience a decline in value that is judged to be other than temporary are written down to fair value and a realized loss is recorded. To calculate realized gains and losses on the sale of investments, the Company uses the specific amortized cost of each investment sold.

Premium taxes - The Company is subject to a 2% premium tax on all payments received from AHCCCS for premiums, reinsurance and reconciliations. Total premium tax expense for the years ended December 31, 2017 and 2016 was approximately $4,055,000 and $4,695,000, respectively. At December 31, 2017 and 2016, premium taxes receivable, resulting from overpayments of premium taxes by the Company, totaled approximately $616,000 and $1,330,000, respectively and is included in capitation and supplement receivables in the accompanying balance sheets.

Health insurer fee - Under the Patient Protection and Affordable Care Act ("ACA"), the Company qualifies as a covered entity of a controlled group engaged in providing health insurance for U.S. health risks. Prior to the acquisition of HNI by Centene, HNI was the designated entity of the controlled group and pooled the premiums of all its subsidiaries to calculate its premium for purposes of determining its share of the health insurer fee under ACA provision 9010. Subsequent to the acquisition, Centene is now the designated entity of the controlled group.

The annual fee equals net premiums written for health insurance during the applicable 'fee year' divided by aggregate net premiums written for all covered entities during the applicable 'fee year' multiplied by the annual applicable amount. Each health insurer's fee is a proportionate share of the total for all health insurers.

The designated entity of the controlled group passes the fee down to its subsidiaries based on an allocation of net premiums written. The health insurer fee is considered an excise tax and thus is nondeductible for income tax purposes. The Company funded approximately $3,933,000 to the designated entity of the controlled group to pay the fees for the calendar year ended December 31, 2016.

AHCCCS has agreed to reimburse the health insurers for this fee and applicable taxes by adjusting the contract premiums by an amount that approximates the TXIX/XXI annual fee grossed up by the Company's effective tax rate. Accordingly, at December 31, 2016, the Company recorded a receivable from AHCCCS of approximately $6,174,000, related to the health insurer fee, in the accompanying balance sheet. The receivable was collected by the Company in 2017.

Effective January 1, 2017, the Internal Revenue Service ("IRS") issued a moratorium on the health insurer fee whereby collection of the health insurer fee for calendar year 2017 was suspended.

Reserves for contingent liabilities - In the course of the Company's operations, the Company is involved on a routine basis in various disputes with members, health care providers, and other entities, as well as audits by government agencies and elected officials that relate to the Company's services and/or business practices that expose the Company to potential losses.

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

The Company recognizes an estimated loss, which may represent damages, assessment of regulatory fines or penalties, settlement costs, future legal expenses, or a combination of the foregoing, as appropriate, from such loss contingencies when it is both probable that a loss will be incurred and that the amount of the loss can be reasonably estimated. The Company's loss estimates are based in part on an analysis of potential results, the stage of the proceedings, consultation with outside counsel, and any other relevant information available.

Alternative payment model liability/shared savings - AHCCCS subjects 1% of gross prospective capitation of Acute contractors in Arizona to measurements based on each contractor's performance on selected Quality Management Performance Measures as determined by AHCCCS. The program is an effort to encourage activity for AHCCCS contractors in the area of quality improvement, particularly those initiatives that are conducive to improved health outcomes and cost savings. As of December 31, 2017 and 2016, the Company accrued approximately $5,749,000 and $3,507,000, respectively, for the alternative payment model liability. The change in the accrual is recorded as a reduction of capitation premium revenue for the years ended December 31, 2017 and 2016.

Medicaid risk adjustment - AHCCCS at times performs a review of the Medicaid program rates for its enrollees and assesses the appropriateness of rates applied to services for those enrollees. In May 2017, AHCCCS performed an analysis to risk adjust the capitation payments made to managed care organizations during contract years 2017 and 2016. The risk adjustment of capitation payments modified revenue to contractors based on the health status of their covered population relative to the average health status of the population. To estimate the impact to its capitation rates for contract years 2017 and 2016, the Company performed an analysis of the impact of the published rate change for its enrolled populations based on member months during those years. The Company estimated amounts payable to AHCCCS for the risk adjustment of approximately $7,233,000 for contract year 2017 and approximately $7,937,000 for contract year 2016. In August 2017, AHCCCS recouped the $7,937,000 related to contract year 2016. As of December 31, 2017, the Company has recorded a payable to AHCCCS for risk adjustment of approximately $7,233,000 which is expected to be recouped in 2018.

Income taxes - Deferred tax assets and liabilities are recorded for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of the tax rate change.

Valuation allowances are provided when it is considered more likely than not that deferred tax assets will not be realized. In determining if a deductible temporary difference or net operating loss can be realized, the Company considers future reversals of existing taxable temporary differences, future taxable income, and tax planning strategies.

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

The Company's policy is to classify income tax penalties and interest as income tax expense in its financial statements. During the years ended December 31, 2017 and 2016, the Company incurred no penalties or interest.

The Company evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts.

Concentrations of credit risk - Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents and receivables from AHCCCS, primarily including capitation and supplement receivables, reinsurance receivables and reconciliation receivables. All cash equivalents are managed within established guidelines, which provide diversity among issuers. Concentration of credit risk with respect to the receivables from AHCCCS is high due to the single payer comprising the Company's customer base. However, since the single payer is the state government, the risk is mitigated.

Substantially all of the Company's revenue is earned in Arizona from its contract with AHCCCS. Failure to renew this contract would have a significant impact on the Company's operations.

Fair value measurements - FASB ASC 820, *Fair Value Measurements,* establishes a common definition for fair value to be applied to accounting principles generally accepted in the United States of America requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. FASB ASC 820 also establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values.

Recent accounting pronouncements - In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), that will supersede most current revenue recognition guidance, including industry-specific guidance. The core principle of the new guidance is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. Additionally, the guidance requires disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized.

In August 2015, the FASB issued FASB ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606)*, which changed the effective date of the provisions of FASB ASU No. 2014-09. As a result, the new effective dates for public business entities, certain not-for-profit entities, and certain employee benefit plans to apply the guidance in FASB ASU No. 2014-09 is for annual reporting periods beginning after December 15, 2017. All other entities should apply the guidance in FASB ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016. Transition to the new guidance may be done using either a full or modified retrospective method. Management does not expect the adoption of this standard to have a material impact on the financial statements.

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

In November 2015, the FASB issued ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. ASU 2015-17 eliminates the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent. The ASU is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company elected to adopt ASU 2015-17 retrospective to the earliest year presented, 2016. As a result, the Company reflected its deferred income tax asset as noncurrent in the accompanying balance sheets as of December 31, 2017 and 2016.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires that a lease liability and related right-of-use-asset representing the lessee's right to use or control the asset be recorded on the balance sheet upon the commencement of all leases except for short-term leases. Leases will be classified as either finance leases or operating leases, which are substantially similar to the classification criteria for distinguishing between capital leases and operating in existing lease accounting guidance. As a result, the effect of leases in the statement of comprehensive (loss) income and the statement of cash flows will be substantially unchanged from the existing lease accounting guidance. The ASU is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect that the adoption of this standard will have a material impact on the financial statements.

Subsequent events - The Company has evaluated subsequent events through April 27, 2018, which is the date the financial statements were available to be issued.

(2) Contract performance bond

In accordance with the terms of its contract with AHCCCS, the Company is required to post a performance bond with AHCCCS equal to 100% of the first monthly AHCCCS payment to the Company each fiscal year based on gross capitation payments, as specified in the contract. The amount of the bond is subject to adjustment as certain conditions change and its method of calculation is specified in the contract. The actual amount is reset each year upon expiration. The performance bond must be maintained to guarantee payment of the Company's obligations under the contract. As of December 31, 2017 and 2016, the Company had a performance bond for the benefit of AHCCCS totaling $22,000,000. The performance bond was overfunded by approximately $2,463,000 and $4,162,000 as of December 31, 2017 and 2016, respectively.

(3) Investments

Investments have been classified as available for sale according to management's intent. The amortized cost of investments and their approximate fair values at December 31, 2017 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Asset-backed	3,012,030	-	(9,400)	3,002,630
Mortgage-backed	3,898,431	12,092	(9,019)	3,901,504
Corporate bonds	15,570,965	22,811	(79,964)	15,513,812
Municipal bonds	12,231,627	40,994	(54,481)	12,218,140
Total	$ 34,713,053	$ 75,897	$ (152,864)	$ 34,636,086

(3) Investments (continued)

The following is a summary of maturities of available-for-sale investments as of December 31, 2017:

Amounts maturing in:	Amortized Cost	Fair Value
One year or less	$ 2,385,996	$ 2,631,689
After one year through five years	11,668,785	11,607,240
After five years through ten years	20,658,272	20,397,157
Total	$ 34,713,053	$ 34,636,086

The Company regularly evaluates its investments for impairment. The Company considers factors affecting the issuer, factors affecting the industry the issuer operates within, and general debt and equity market trends. The Company considers the length of time an investment's fair value has been below carrying value, the severity of the decline, the near term prospects for recovery to cost, and the Company's intent and ability to hold the investment until maturity or market recovery is realized. If and when a determination is made that a decline in fair value below the cost basis is other than temporary, the related investment is written down to its estimated fair value through a charge to realized losses on investments. For the year ended December 31, 2017, there were no other than temporary impairments of investments.

(4) Fair value measurements

FASB ASC 820 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

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

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

Level 3: Unobservable inputs for the asset or liability.

The following table summarizes the valuation of the Company's assets subject to recurring fair value measurement by the above FASB ASC 820 categories as of December 31, 2017.

	Total	Level 1	Level 2	Level 3
Asset-backed	$ 3,002,630	$ -	$ 3,002,630	$ -
Mortgage-backed	3,901,504	-	3,901,504	-
Corporate bonds	15,513,812	-	15,513,812	-
Municipal bonds	12,218,140	-	12,218,140	-
Total	$ 34,636,086	$ -	$ 34,636,086	$ -

The Company had no assets subject to recurring fair value measurement as of December 31, 2016.

(5) Income taxes

Federal income tax returns are filed on a consolidated basis with the parent corporation and other subsidiaries. A provision for (benefit from) income taxes has been provided for under a separate return method. This results in each component company of the consolidated group showing tax provision solely on the results of its own operations and respective tax rate. The effective tax rate is different than the amount that would be computed by applying the United States corporate income tax rate to the income before income taxes. These differences are a result of multiple items, including permanent book/tax differences and state tax filings.

Current taxes which would have been due on a separate company basis have either been paid to or will be paid to the parent company. The income tax provision (benefit) disclosed below is settled through intercompany transactions in the normal course of business. Deferred income tax assets and liabilities are computed based upon cumulative temporary differences in financial reporting and taxable income based on enacted tax law in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets result from reserves established for financial reporting purposes that are not deductible for tax purposes.

Income tax benefits provided by the Company to the consolidated group as a result of utilizing operating losses will be reimbursed by the parent corporation pursuant to a signed agreement between the companies.

Significant components for the income tax provision (benefit) are as follows for the years ended December 31:

Current (benefit) provision:	2017	2016
Federal	$ (4,657,743)	$ 2,258,446
State and local	(151,640)	-
Total current (benefit) provision	(4,809,383)	2,258,446
Deferred (benefit) provision	(496,492)	7,980,698
Total (benefit) provision for income taxes	$ (5,305,875)	$ 10,239,144

A reconciliation of the federal income tax rate and the effective income tax rate is as follows for the years ended December 31:

	2017	2016
Income taxes at federal rate	$ (5,442,742)	$ 8,763,343
Health insurer fee	-	1,376,523
State tax	(159,074)	-
Tax reform	420,672	-
Other - net	(124,731)	99,278
	$ (5,305,875)	$ 10,239,144

(5) Income taxes (continued)

The components of deferred income tax assets (liabilities) included in the accompanying balance sheets are as follows:

Deferred income tax assets (liabilities):	2017	2016
Deferred revenue	$ 274,730	$ -
Loss reserves	244,705	158,054
Allowance for doubtful accounts	253,775	61,116
Prepaid insurance	(17,346)	-
Unrealized gain	18,390	-
Other	(2,202)	-
Net deferred income tax asset	$ 772,052	$ 219,170

As of December 31, 2017 and 2016, the Company had no federal net operating loss carryforwards. Accordingly, no valuation allowances have been provided to account for the potential limitations on utilization of tax benefits.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, exclusive of related interest, is as follows for the years ended December 31:

	2017	2016
Gross unrecognized tax benefits, beginning of year	$ 100,604	$ 118,007
Increases (decreases) in unrecognized tax benefits related to current year	142,507	(17,403)
Gross unrecognized tax benefits, end of year	$ 243,111	$ 100,604

Of the $243,111 and $100,604 total liabilities for unrecognized tax benefits as of December 31, 2017 and 2016, respectively, none would, if recognized, affect the Company's effective tax rate. The entire liability would result in adjustments to deferred tax assets. In the next twelve months, the Company does not believe that its unrecognized tax benefits will change significantly due to the potential resolution of tax matters. Accordingly, all amounts are classified as long-term.

The Company files tax returns in the federal as well as several state tax jurisdictions as part of a consolidated group. The income tax provision (benefit) disclosed above is settled through intercompany transactions in the normal course of business. As of December 31, 2017, HNI is under federal examination for tax years 2011 through its final return in 2016. Additionally, Centene's tax returns for years 2014 through 2016 are subject to federal examination. The most significant state tax jurisdiction for the consolidated group is California, and tax years subject to examination by that jurisdiction are 2012 and forward. Presently, the consolidated group is undergoing examination by various state taxing authorities. The Company does not believe that any ongoing examination will have a material impact on its balance sheets and statements of comprehensive (loss) income.

(6) Related party transactions

The Company relies on affiliate services to conduct its business in order to achieve cost savings. The Company does nevertheless exercise ultimate control over its assets and operations and retains the ultimate authority and responsibility regarding its powers, duties, and responsibilities.

(6) Related party transactions (continued)

On April 1, 2016, the Company and Centene Management Company ("CMC") entered into a management agreement whereby CMC agrees to manage the general and administrative function of the Company inclusive of payroll, facilities, and other administrative expenses. The management agreement renews annually unless amended or terminated by either party. The Company recorded management fees per the management agreement of approximately $21,525,000 and $19,393,000 for the years ended December 31, 2017 and 2016, respectively. This amount is included in administrative expenses in the accompanying statements of comprehensive (loss) income. As of December 31, 2017 and 2016, the Company recorded approximately $1,804,000 and $2,081,000, respectively, due from CMC related to the management services agreement which is included in due from affiliates in the accompanying balance sheets. Balances associated with this service agreements are settled within 30 days in the normal course of business.

Prior to its agreement with CMC, the Company was a party to an administrative service agreement with HNI and its affiliates, which authorized certain services to be performed on behalf of the Company and vice versa. The entities performing the services were compensated according to the terms set forth in the agreements. For the year ended December 31, 2016, expenses incurred by the Company under this agreement totaled approximately $2,374,000 and were included in administrative expenses. The Company is a party to a tax sharing agreement with HNI whereby allocations are made primarily on a separate company basis using the percentage method pursuant to provisions of IRC Sections §1502 and §1552 and Treasury Regulations §1.1502 and §1.1552.

The Company is a party to a Claims Administration Service Agreement with Health Net Pharmaceutical Services ("HNPS"), an affiliated company wholly owned by HNI which is wholly owned by Centene. HNPS provides pharmacy benefit management services to eligible enrollees. The Company incurred expense to HNPS of approximately $49,400,000 and $44,440,000, net of rebates, for these services for the years ended December 31, 2017, and 2016, respectively. These amounts are included in other medical services in the accompanying statements of comprehensive (loss) income. Claims encounters are submitted to AHCCCS to substantiate these payments. HNPS also receives an administration fee from the Company for administering the pharmacy claims processing. For the years ended December 31, 2017 and 2016, respectively, these administration fees approximated $349,000 and $967,000 and are included in administrative expenses in the accompanying statements of comprehensive (loss) income.

Envolve Vision, Inc., an affiliated company wholly owned by Envolve Holdings, Inc. which is wholly owned by Centene, provides a vision network and manages the vision benefits for eligible enrollees pursuant to an agreement with the Company that was established on July 1, 2016. The Company incurred expense to Envolve Vision, Inc. of approximately $573,000 and $308,000 for these services during the years ended December 31, 2017 and 2016, respectively. These amounts are included in other medical services in the accompanying statements of comprehensive (loss) income. As of December 31, 2017 and 2016, respectively, the Company has approximately $56,000 and $0 due to Envolve Vision, Inc. which are included in medical claims payable in the accompanying balance sheets.

Envolve Dental, Inc., an affiliated company wholly owned by Envolve Holdings, Inc. which is wholly owned by Centene, provides dental services for eligible enrollees pursuant to an agreement with the Company that was established on October 1, 2016. The Company incurred expense to Envolve Dental, Inc. approximately $5,113,000 and $1,221,000 for these services during the years ended December 31, 2017 and 2016, respectively. These amounts are included in other medical services in the accompanying statements of comprehensive (loss) income. As of December 31, 2017 and 2016, respectively, the Company has approximately $497,000 and $1,221,000 due to Envolve Dental, Inc. which are included in medical claims payable in the accompanying balance sheets.

(6) Related party transactions (continued)

Envolve PeopleCare, Inc., an affiliated company wholly owned by Envolve Holdings, Inc. which is wholly owned by Centene, provides disease management, nurse triage, and call center services to eligible enrollees through a contract with HNI that was established July 1, 2016. The Company incurred expense to HNI related to the services provided by Envolve PeopleCare, Inc. of approximately $73,000 and $122,000 during the years ended December 31, 2017 and 2016, respectively. These amounts are included in other medical services in the accompanying statements of comprehensive (loss) income. As of December 31, 2017 and 2016, respectively, the Company has approximately $0 and $122,000 due to HNI related to the services provided by Envolve PeopleCare, Inc. which are included in medical claims payable in the accompanying balance sheets.

In 2017, the Company declared and paid a dividend to Centene, through HNI, in the amount of $10,000,000. In 2016, Centene, through HNI, contributed capital in the amount of $15,000,000.

(7) Commitments and contingencies

Liability insurance - The Company, through Centene, maintains professional and general liability insurance. The professional liability coverage is written on a claims made basis and insures losses up to $15,000,000 with a self-insured retention of $5,000,000. There is an umbrella policy over the professional liability coverage with a limit of $15,000,000. The general liability insurance is written on an occurrence basis and insures losses up to $1,000,000 per claim and $2,000,000 in the aggregate. There is also an umbrella policy over the general liability insurance with a limit of $25,000,000. Claims reported endorsement (tail coverage) is available if the professional policy is not renewed to cover claims incurred but not reported. The Company anticipates that renewal coverage will be available at the expiration of the current policy. The Company participates in the above policy with its affiliates. Per claim and aggregate limits are applicable to all covered entities as a group.

Litigation - Periodically, the Company may be involved in litigation and claims arising in the normal course of operations. In the opinion of management based on consultation with legal counsel, losses, if any, from these matters are covered by insurance or are immaterial.

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

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