

FINANCIAL STATEMENTS AND SUPPLEMENTARY  
INFORMATION

Maricopa Health Plan  
(A Department of Maricopa Integrated Health System)  
Years Ended June 30, 2017 and 2016  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

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

Financial Statements and Supplementary Information

Years Ended June 30, 2017 and 2016

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Ernst & Young LLP  
Ernst & Young Tower  
One Renaissance Square  
Suite 2300  
2 North Central Avenue  
Phoenix, AZ 85004

Tel: +1 602 322 3000  
Fax: +1 602 322 3023  
ey.com

## Report of Independent Auditors

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

We have audited the accompanying financial statements of Maricopa Health Plan (a department of Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System) (MHP) as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise MHP's financial statements as listed in the table of contents.

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

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

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Maricopa Health Plan (a department of Maricopa Integrated Health System) as of June 30, 2017 and 2016, and the changes in its net position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

## **Required Supplementary Information**

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 3–7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying detail of sub-capitated expense is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.



December 19, 2017

Maricopa Health Plan  
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Management's Discussion and Analysis

**Introduction**

MHP, a department of Maricopa Integrated Health System (MIHS), offers readers of its financial statements this narrative overview of the current financial position, results of operations, and cash flows for MHP for the years ended June 30, 2017 and 2016. The narrative within contains required supplemental information, which should be read in conjunction with MHP's audited financial statements, including the notes thereto.

**Overview of the Financial Statements**

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

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

All of the current year's revenues and expenses are accounted for in the statements of revenues, expenses, and changes in net position. These statements measure the financial performance of MHP's operations for the years ended June 30, 2017 and 2016, and can be used to determine whether MHP has successfully recovered all of its costs through its revenue sources. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

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

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

**Management's Discussion and Analysis (continued)**

**Overview of MHP**

Maricopa Health Plan is a department of Maricopa Integrated Health System (MIHS) and provided health plan services to enrollees under a contract, through January 2017, with the Arizona Health Care Cost Containment System (AHCCCS) in Maricopa County, Arizona. MIHS has notified AHCCCS that they will not continue the contract after January 31, 2017, due to the acquisition of the plan by an external party. MHP is responsible for all provisions of the AHCCCS contract through the contract termination date of January 31, 2017, including settlement of the reconciliation receivable and payable with AHCCCS and payment of medical claims for services rendered to enrolled members through January 31, 2017.

In addition to the AHCCCS contract, MIHS held a contract with the Centers for Medicare & Medicaid Services (CMS) in calendar year 2016 for the operation of a Medicare Advantage Prescription Drug (MAPD) health plan through Maricopa Care Advantage (a department of MIHS). AHCCCS requires all acute care contractors to hold a MAPD contract with CMS to encourage coordination of care between primary and secondary payors. The financial results of the MAPD are not included in MHP's financial statements, but rather are reported elsewhere.

**Financial Analysis of MHP**

The statements of net position and the statements of revenues, expenses, and changes in net position report the net position of MHP and the related changes. MHP's net position (the difference between total assets and total liabilities) is a way to measure its financial health, or financial position. Over time, sustained increases or decreases in MHP's net position are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors, such as changes in economic conditions, population growth, and new governmental legislation, should also be considered.

**Statements of Net Position**

*Liquidity:* As of June 30, 2017 and 2016, MHP has cash of \$22,550,870 and \$57,442,403, respectively. Cash consists of cash held in depository accounts in the name of MHP. The carrying amount approximates fair value because of the highly liquid nature of these accounts.

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Management's Discussion and Analysis (continued)

*Assets:* MHP's total assets are \$37,153,509 and \$68,072,522 as of June 30, 2017 and 2016, respectively. MHP has no assets held in bonds or money market mutual funds. MHP has no assets held in foreign investments, investments with contractual sales restrictions, equity interests, or in nonaffiliated, privately placed equities. MHP has neither mortgage loans nor any assets held in real estate.

At June 30, 2017 and 2016, respectively, MHP reported a receivable of \$8,510,994 and \$174,589 for capitation and supplemental revenue and \$3,794,153 and \$5,183,227 for reconciliation receivable due from AHCCCS. The June 30, 2017, capitation and supplemental receivable is a result of risk adjustment changes that AHCCCS made to MHP's capitation rates. The receivable was paid subsequent to June 30, 2017.

MHP receives reinsurance coverage from the state of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The gross capitation rates were reduced by the reinsurance cost. Under the state program, risk of loss for inpatient claims is generally limited to an annual deductible of \$25,000 for 2017 and 2016 per member, per policy year. Eligible claims in excess of the deductible are generally paid by the state at 75% to 85% of amount paid by the plan, with no maximum annual benefit. MHP's reinsurance receivable reported at June 30, 2017 and 2016, was \$992,679 and \$4,328,233, respectively.

*Liabilities:* MHP reported total liabilities of \$26,018,750 and \$48,610,003 as of June 30, 2017 and 2016, respectively. As of June 30, 2017 and 2016, respectively, MHP reported \$21,564,414 and \$13,289,416 for reconciliation payable due to AHCCCS, which includes \$8,047,768 and \$4,731,391 in AHCCCS payment reform obligations.

At June 30, 2017 and 2016, MHP reported \$2,520,000 and \$31,763,100, respectively, for medical claims payable. The costs of hospital and medical services provided to enrollees served under contract are recognized in the period that the services are rendered. A provision has been made for claims in process of review and for claims incurred but not reported at year-end. The amount of this liability is computed using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term. Management believes that the medical claims payable is adequate.

*Net Position:* MHP had ending net position of \$11,134,759 and \$19,462,519 at June 30, 2017 and 2016, respectively. The decrease of \$8,327,760 is the result of deficiency of revenues over expenses at June 30, 2017, as reported within the statements of revenues, expenses and changes in net position.

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Management's Discussion and Analysis (continued)

**Statements of Revenues, Expenses, and Changes in Net Position**

MHP reported excess of expenses over revenue of \$8,327,760 and excess of revenue over expenses of \$4,286,390 for the years ended June 30, 2017 and 2016, respectively. MHP reported revenues of \$142,340,437 and \$304,647,612 for the years ended June 30, 2017 and 2016, respectively. Prospective Tiered and PPC capitation received from AHCCCS for MHP members totaled \$155,172,119 and \$293,794,529 for the years ended June 30, 2017 and 2016, respectively. MHP receives delivery supplemental revenue upon the delivery of a child by a member during a prospective enrollment period. This supplemental payment does not include payment for deliveries of those members who deliver in a prior coverage period. Delivery supplemental revenue for the years 2017 and 2016 totaled \$5,663,715 and \$10,623,729, respectively.

Total health care expenses, net of reinsurance and third-party liability, were \$132,309,276 and \$270,445,556 for the years ended June 30, 2017 and 2016, respectively.

Administrative expenses for 2017 and 2016 consist of the management fee paid to the administrator of MHP. Until February 28, 2015, University Physicians Healthcare (UPH) was the administrator of MHP. Effective February 28, 2015, UPH was acquired by Banner Health (Banner), and Banner became successor to UPH in this management contract. The total management fees incurred were \$14,585,315 and \$23,432,397, and other administrative expenses of \$156,501 and \$177,448 were incurred for the years ended June 30, 2017 and 2016, respectively. For the year ended June 30, 2016, the management fee payable to the administrator of MHP was calculated at 7.75% of the revenue collected by MHP. For the year ended June 30, 2017, the management fee payable to the administrator of MHP was calculated at 8.25% of the revenue collected by MHP through January 31, 2017, plus an additional contracted amount associated with the run out activities for the plan subsequent to January 31, 2017.



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**Management's Discussion and Analysis (continued)**

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

*Premium Tax:* The state of Arizona imposes a premium tax on capitation payments paid to MHP by AHCCCS. MHP receives amounts equal to the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. MHP includes the taxes collected as revenues and taxes remitted as an expense in the accompanying statements of revenues, expenses and changes in net position. Premium tax expense of \$3,617,105 and \$6,305,821 was reported for 2017 and 2016, respectively.

**Contacting Maricopa Health Plan**

MHP's financial statements are designed to present readers with a general overview of MHP's finances and attempt to demonstrate MHP's accountability and transparency. If you have questions about the report or need additional financial information, please contact Administration at Maricopa Integrated Health System, 2601 East Roosevelt Street, Phoenix, AZ 85008.

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Statements of Net Position

	<b>June 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Assets</b>		
Current assets:		
Cash	\$ 22,550,870	\$ 57,442,403
Reinsurance receivable	992,679	4,328,233
Capitation and supplemental revenue receivable	8,510,994	174,589
Reconciliation receivable	3,738,978	989,241
Other current assets	1,304,813	944,070
Total current assets	37,098,334	63,878,536
Reconciliation receivable	55,175	4,193,986
Total assets	\$ 37,153,509	\$ 68,072,522
<b>Liabilities and net position</b>		
Current liabilities:		
Accounts payable	\$ 635,526	\$ 1,347,955
Accrued administrative costs	812,500	1,912,875
Medical claims payable	2,520,000	31,763,100
Shared savings payable	136,756	87,076
Reconciliation payable	11,626,860	4,991,742
Other current liabilities	349,554	209,581
Total current liabilities	16,081,196	40,312,329
Reconciliation payable	9,937,554	8,297,674
Total liabilities	26,018,750	48,610,003
Unrestricted net position	11,134,759	19,462,519
Total liabilities and net position	\$ 37,153,509	\$ 68,072,522

*See notes to financial statements.*

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Statements of Revenues, Expenses, and Changes in Net Position

	<b>Year Ended June 30</b>	
	<b>2017</b>	<b>2016</b>
Revenues and gains, net:		
Capitation	<b>\$ 154,394,194</b>	\$ 278,995,315
PPC capitation	<b>777,925</b>	14,799,214
Delivery supplement	<b>5,663,715</b>	10,623,729
Adults <=106 reconciliation settlement	-	(31,181)
PPC reconciliation settlement	<b>(2,136,295)</b>	3,164,105
Prospective tiered reconciliation settlement	<b>(13,015,505)</b>	(1,839,377)
Adults > 106 reconciliation settlement	<b>(3,278,349)</b>	(1,214,245)
PCP parity cost settlement	<b>(83,055)</b>	6,833
Investment income	<b>17,807</b>	143,219
Total revenues and gains, net	<b>142,340,437</b>	304,647,612
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	<b>27,886,940</b>	51,807,449
PPC — hospital inpatient	<b>784,305</b>	12,156,203
Total hospitalization expenses	<b>28,671,245</b>	63,963,652
Medical compensation expenses:		
Primary Care Physician Services	<b>3,546,894</b>	31,821,933
Behavioral Health Services	<b>439,912</b>	-
Referral Physicians Services	<b>19,582,467</b>	32,800,379
FQHC/RHC Services	<b>7,014,116</b>	-
Other Professional Services	<b>6,276,795</b>	10,894,484
PPC - Physician Services	<b>115,640</b>	1,792,373
PCP Parity Enhanced Payment	-	6,833
Total medical compensation expenses	<b>36,975,824</b>	77,316,002
Other medical expenses:		
Emergency facility services	<b>14,078,128</b>	27,833,847
Pharmacy	<b>24,547,716</b>	47,389,638
Lab, X-ray, and medical imaging	<b>7,149,774</b>	13,290,669
Outpatient facility	<b>11,187,094</b>	23,012,882
Durable medical equipment	<b>1,838,549</b>	2,417,569
Dental	<b>5,529,730</b>	10,218,851

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Statements of Revenues, Expenses, and Changes in Net Position (continued)

	<b>Year Ended June 30</b>	
	<b>2017</b>	<b>2016</b>
Transportation	\$ 4,036,089	\$ 7,996,315
Nursing facility, home health care	3,634,382	5,561,418
Physical therapy	110,300	382
Behavioral Health Services	109,640	–
Shared savings arrangements	159,792	18,577
PPC – other	261,735	2,983,769
Total other medical expenses	72,642,929	140,723,917
Total health care expenses	138,289,998	282,003,571
Less:		
Reinsurance recoveries	4,557,459	9,653,086
Third-party liability, net of collection fees	1,423,263	1,904,929
Total net health care expenses	132,309,276	270,445,556
Administrative expenses:		
Management fees	14,585,315	23,432,397
Other	156,501	177,448
Total administrative expenses	14,741,816	23,609,845
Premium taxes	3,617,105	6,305,821
Total operating expenses	150,668,197	300,361,222
(Deficiency) excess of revenues over expenses	(8,327,760)	4,286,390
Distribution to Maricopa Integrated Health System	–	(3,500,000)
(Decrease) increase in unrestricted net position	(8,327,760)	786,390
Unrestricted net position, beginning	19,462,519	18,676,129
Unrestricted net position, ending	\$ 11,134,759	\$ 19,462,519

*See notes to financial statements.*

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Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating activities</b>		
Cash received for capitation and other operating receipts	\$ 166,376,111	\$ 307,797,495
Cash paid to providers and facilities	(167,533,098)	(275,918,508)
Cash paid for administrative expenses	(33,734,546)	(30,001,049)
Net cash (used in) provided by operating activities	(34,891,533)	1,877,938
<b>Investing activities</b>		
Change in due from affiliate	—	31,428,586
Net cash provided by investing activities	—	31,428,586
<b>Noncapital financing activities</b>		
Distribution to Maricopa Integrated Health System	—	(3,500,000)
Net cash used in noncapital financing activities	—	(3,500,000)
Net (decrease) increase in cash	(34,891,533)	29,806,524
Cash, beginning	57,442,403	27,635,879
Cash, ending	\$ 22,550,870	\$ 57,442,403
Reconciliation of (deficiency) excess of revenues over expenses to net cash (used in) provided by operating activities:		
(Deficiency) excess of revenues over expenses	\$ (8,327,760)	\$ 4,286,390
Adjustments to reconcile (deficiency) excess of revenues over expenses to net cash (used in) provided by operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	3,335,554	(821,191)
Capitation and supplemental revenue receivable	(8,336,405)	(82,181)
Other current assets	(360,743)	(465,254)
Reconciliation receivable	1,389,074	(2,459,455)
Accounts payable and accrued administrative costs	(1,812,804)	451,938
Medical claims payable	(29,243,100)	6,085,063
Reconciliation payable	8,274,998	(5,068,861)
Shared savings payable	49,680	87,076
Other current liabilities	139,973	(135,587)
Total adjustments	(26,563,773)	(2,408,452)
Net cash (used in) provided by operating activities	\$ (34,891,533)	\$ 1,877,938

*See notes to financial statements.*

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Notes to Financial Statements

June 30, 2017

## 1. Organization and Operations

### Organizational Structure

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

All of MHP's revenues were earned under its AHCCCS contract. In March 2013, MHP was awarded a new five-year contract with AHCCCS to operate MHP through September 30, 2018. MIHS notified AHCCCS that they would not continue the contract after February 1, 2017 due to the acquisition of the plan by an external party. MHP is responsible for all provisions of the AHCCCS contract through the contract termination date of January 31, 2017, including settlement of the reconciliation receivable and payable with AHCCCS and payment of medical claims for services rendered to enrolled members through January 31, 2017.

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

## 2. Summary of Significant Accounting Policies

### Basis of Accounting

MHP is a managed 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. MHP follows applicable Governmental Accounting Standards Board (GASB) principles and prepares its financial statements on the accrual basis of accounting using the economic resources measurement focus.

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**Notes to Financial Statements (continued)**

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

**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 reported 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. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

**Fair Value of Financial Instruments**

The carrying amounts for financial accounts classified within current assets and current liabilities approximate fair value due to the short-term nature of these accounts.

**Cash**

During 2017 and 2016, cash consists of cash held in depository accounts in the name of MHP. The carrying amount approximates fair value because of the highly liquid nature of these accounts. MHP maintains cash in a bank account that frequently exceeds federally insured limits. To date, MHP has not experienced any losses in such accounts. The depository insurance related to these bank balances at June 30, 2017 and 2016, was \$250,000. At June 30, 2017 and 2016, MHP had a book balance of cash of \$22,550,870 and \$57,442,403, respectively, and a bank balance of \$22,927,294 and \$60,352,836, respectively. As MHP operates as a department of MIHS, MIHS assumes any custodial credit risk related to MHP cash balances.

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Notes to Financial Statements (continued)

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

**Reinsurance Receivable**

Reinsurance receivable represents management's estimate of the medical claim cost it has earned that will be recoverable under its reinsurance contract with AHCCCS and is calculated based on the identification of qualifying incurred inpatient and pharmacy expenses and a percentage of estimated inpatient and certain pharmaceutical costs incurred but not yet reported. As a result, there is a possibility that recorded estimates will change by a material amount in the near term. MHP recorded changes in estimate for reinsurance recoveries of approximately \$460,000 during 2017 that relate to services provided in 2016, and approximately \$780,000 during 2016 that relate to services provided in 2015, which are recorded as an increase to reinsurance recoveries on the accompanying statements of revenues, expenses and changes in net position.

**Medical Claims Payable**

The costs of hospital and medical services provided to enrollees served under contract are recognized in the period the services are rendered. An accrual has been recorded for unpaid claims in process of review and for claims incurred but not reported as of June 30, 2017 and 2016. The amount of this liability is estimated by independent actuaries using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Because considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term (See Note 3). Management believes that the medical claims payable recorded is adequate as of June 30, 2017 and 2016.

**Premium Deficiency Reserve**

MHP performs periodic analysis of its expected future health care costs and maintenance costs to determine whether such costs will exceed anticipated future revenues under its contracts. Should expected costs exceed anticipated revenues, a premium deficiency reserve is recognized. Investment income is not included in the calculation of premium deficiency reserves. At June 30, 2017 and 2016, contracted rates and anticipated expenses did not warrant a premium deficiency reserve.



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Notes to Financial Statements (continued)

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

**Unrestricted Net Position**

Unrestricted net position is the remaining net position that does not meet the definition of restricted or invested in capital assets in accordance with GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

**Capitation Revenues**

Capitation revenues include premiums earned under contracts that require MHP to provide health care services to subscribers of AHCCCS. The monthly capitation revenues have been agreed upon by MHP and AHCCCS. Capitation revenues are recognized as revenue in the period to which health care coverage relates. Amounts receivable under these contracts are recorded as capitation and supplemental revenue receivable. Capitation rates are subject to adjustment based on national episodic/diagnostic risk. As such, there is a possibility that recorded amounts will change by a material amount in the near term. For the year ended June 30, 2017, MHP recorded additional capitation revenue of approximately \$5,051,000 as a result of risk adjustment changes AHCCCS made to the 2016 capitation rates received. Such amount has been recorded as capitation receivable on the statements of net positions as of June 30, 2017.

MHP received capitation payments for prior period coverage (PPC) separately from its prospective capitation payments. PPC capitation payments are intended to cover health care costs incurred by individuals while waiting for enrollment in MHP. PPC revenues are recognized in the month in which the member is eligible for coverage by MHP.

**Supplemental Revenue**

Delivery supplemental revenue is recognized upon the delivery of a child by a member assigned to MHP during a prospective enrollment period. This supplemental payment does not include payment for deliveries of those members who deliver in a prior coverage period.

**Reconciliation Settlement Receivable (Payable) and Revenue (Contra-Revenue)**

Certain AHCCCS programs are subject to settlement with AHCCCS based on the programs' net income or loss realized by MHP, based on a formula defined by the AHCCCS contract (reconciliation receivable (payable)). The reconciliation settlement period is based on the

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Notes to Financial Statements (continued)

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

AHCCCS contract period of October 1 through September 30 and is subject to review and final settlement with AHCCCS. As of June 30, 2017, AHCCCS has settled the reconciliation receivable (payable) with MHP through September 30, 2015. The estimated reconciliation receivable (payable) for contract years ending, September 30, 2016 and through June 30, 2017, has been recorded as estimated reconciliation receivable (payable) on the statements of net position. A change in estimate of approximately \$12,165,000 was recorded as a decrease to reconciliation settlement revenue for the year ended June 30, 2017, primarily due to the finalization of the September 2014 and 2015 contract year reconciliations.

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

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

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

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Notes to Financial Statements (continued)

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

**Payment Reform**

AHCCCS has developed the payment reform policy with the intent to drive innovative arrangements that will further enhance cost control and result in quality improvements, while also offering providers incentive to participate in these arrangements. MHP is required to participate in these payment reform efforts as delineated by AHCCCS. MHP has a payable to AHCCCS, reported within reconciliation payable on the statements of net position for approximately \$8,000,000 and \$4,700,000 as of June 30, 2017 and 2016, respectively, related to this policy.

**Administrative Expenses**

Administrative expenses are recognized as incurred and consist of the management fee paid to the administrator of MHP (see Note 5). Up to February 28, 2015, UPH was the administrator of MHP. UPH was acquired by Banner on February 28, 2015, and Banner became successor to UPH in this management contract.

**Premium Tax**

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

**Income Taxes**

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

**Risk Management**

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

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Notes to Financial Statements (continued)

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

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

**Subsequent Events**

All of the effects of subsequent events that provide additional evidence about conditions that existed at the financial statement date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. MHP does not recognize subsequent events that provide evidence about conditions that did not exist at the financial statement date but arose after, but before the financial statements are available to be issued. However, non-recognized subsequent events are disclosed. MHP has evaluated events and transactions occurring subsequent to June 30, 2017 through December 19, 2017, the date of issuance of the financial statements. During this period, there were no events requiring recognition in the financial statements. Additionally, there were no non-recognized subsequent events requiring disclosure.

**Reclassifications**

Certain amounts in the 2016 financial statements have been reclassified to conform to the 2017 presentation, primarily related to the reclassification of approximately \$4,731,000 of payment reform liability to reconciliation payable as a result of communication received from AHCCCS, during fiscal 2017, relating to the financial presentation of the payment reform liability.

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Notes to Financial Statements (continued)

**3. Medical Claims Payable**

Medical claims liability consists of the following at June 30:

	<b>2017</b>	<b>2016</b>
Claims payable or pending approval	\$ <b>970,594</b>	\$ 24,838,462
Provisions for claims incurred but not yet reported	<b>1,549,406</b>	6,924,638
	<b>\$ 2,520,000</b>	\$ 31,763,100

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. MHP estimates accrued claims payable based on historical claims payments and other relevant information. Estimates are continually monitored and reviewed, and as medical claims are paid or estimates adjusted, differences are recorded 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 recorded. 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 medical claims liability for the years ended June 30:

	<b>2017</b>	<b>2016</b>
Beginning balance	\$ <b>31,763,100</b>	\$ 25,678,037
Incurred:		
Current	<b>133,761,755</b>	277,969,056
Prior	<b>4,528,243</b>	4,034,515
Total	<b>138,289,998</b>	282,003,571
Paid:		
Current	<b>131,241,755</b>	245,517,917
Prior	<b>36,291,343</b>	30,400,591
Total	<b>167,533,098</b>	275,918,508
Ending balance	<b>\$ 2,520,000</b>	\$ 31,763,100

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Notes to Financial Statements (continued)

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

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

**4. Related-Party Transactions**

MHP purchased hospitalization and medical compensation services from MIHS. For the years ended June 30, 2017 and 2016, MHP incurred claims from MIHS totaling approximately \$21,623,000 and \$34,500,000, respectively.

**5. Commitments and Contingencies**

**Litigation**

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

**AHCCCS Performance Measures**

MHP's contract with AHCCCS requires MHP to be in compliance with certain financial and quality performance measures, as defined in the AHCCCS contract. For the contract year ended September 30, 2013, management determined that MHP did not meet certain quality AHCCCS performance measures. In response to these violations, AHCCCS may require MHP to submit corrective action plans and subject MHP to sanctions. At June 30, 2017 and 2016, MHP has recognized a liability of \$175,000 related to this contingency within other current liabilities. Due to the uncertainty of the outcome of AHCCCS' review, it is reasonably possible that recorded estimates will change by a material amount in the near term. Management believes that MHP is in compliance with these measures for contract periods ending after September 30, 2013, through January 31, 2017. Compliance with these performance measures can be subject to future review by AHCCCS and may result in sanctions unknown or unasserted at this time.

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Notes to Financial Statements (continued)

**5. Commitments and Contingencies (continued)**

**Performance Bond**

MIHS secured an annual performance bond on behalf of MHP in the amount of \$25,000,000 with an unrelated third-party insurance company to satisfy the performance bond requirement of MHP's AHCCCS contract. The bond satisfies MHP's contractual obligation as prescribed by AHCCCS. Beginning October 1, 2017, the annual performance bond was reduced to \$18,310,000 and expires on September 30, 2018. A performance bond is required until released by AHCCCS.

**Contract With Banner Health**

MHP has a management agreement with Banner through December 31, 2018, that provides for payments to Banner based on a percentage of revenue per month (as defined) as consideration for services rendered through January 31, 2017. Subsequent to this date, the management fees are contracted and based on a fixed disbursement schedule to be paid through December 2018. Management fees to Banner are classified under administrative expenses in the statements of revenues, expenses and changes in net position.

**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 necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, and reimbursement for patient services. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. 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 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.

# Supplementary Information



Maricopa Health Plan  
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Detail of Sub-Capitated Expense

Year Ended June 30, 2017

Dental expenses	\$ 5,525,330
Total sub-capitated expense	<u>\$ 5,525,330</u>

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