MERCY MARICOPA INTEGRATED CARE

FINANCIAL STATEMENTS,
ADDITIONAL INFORMATION AND
UNIFORM GUIDANCE SUPPLEMENTAL REPORTS

Years Ended June 30, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of

MERCY MARICOPA INTEGRATED CARE

We have audited the accompanying financial statements of ***Mercy Maricopa Integrated Care***, which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities and changes in net assets, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 ***Mercy Maricopa Integrated Care*** as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the financial statements of ***Mercy Maricopa Integrated Care*** as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principals and Audit Requirements for Federal Awards*, 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 of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2017, on our consideration of ***Mercy Maricopa Integrated Care's*** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ***Mercy Maricopa Integrated Care's*** internal control over financial reporting and compliance.

Mayer Hoffman McCann P.C.

October 25, 2017

MERCY MARICOPA INTEGRATED CARE

STATEMENTS OF FINANCIAL POSITION

June 30, 2017 and 2016

ASSETS

	2017	2016
CURRENT ASSETS		
Cash and cash equivalents	$ 249,915,962	$ 235,239,030
Receivables:		
Pharmacy rebate receivables	1,571,275	2,727,501
Provider advances, net of allowance for doubtful accounts of $207,132 and $0, respectively	1,826,759	801,734
Risk share settlement	-	1,095,606
Other accounts receivable, net of allowance for doubtful accounts of $47,272, and $0, respectively	1,034,639	114,372
Due from AHCCCS	284,845	9,303,955
Due from Aetna	48,972	1,425,542
Prepaid assets	1,362,097	7,667,199
TOTAL CURRENT ASSETS	256,044,549	258,374,939
RESTRICTED SECURITIES	438,076	520,036
CAPITALIZED SOFTWARE COSTS, net	1,345,895	2,114,978
TOTAL ASSETS	$ 257,828,520	$ 261,009,953

LIABILITIES AND NET ASSETS

	2017	2016
CURRENT LIABILITIES		
Claims payable	$ 65,541,496	$ 57,413,366
Payable to providers	20,843,211	18,323,984
Due to AHCCCS	15,690,554	36,156,954
Deferred revenue	3,795,312	5,667,628
Due to District	18,849,539	17,400,021
Other current liabilities	2,961,029	4,114,559
TOTAL CURRENT LIABILITIES	127,681,141	139,076,512
UNRESTRICTED NET ASSETS	130,147,379	121,933,441
TOTAL LIABILITIES AND NET ASSETS	$ 257,828,520	$ 261,009,953

MERCY MARICOPA INTEGRATED CARE

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2017 and 2016

	2017	2016
OPERATING REVENUES		
Arizona Health Care Cost Containment System contract revenues	$ 1,313,048,824	$ 1,148,797,221
Centers for Medicare and Medicaid Services contract revenues	(59,342)	13,779,903
Reinsurance	-	(54,393)
TOTAL OPERATING REVENUES	1,312,989,482	1,162,522,731
HEALTH CARE EXPENSES	1,177,271,424	1,038,562,815
GENERAL AND ADMINISTRATIVE EXPENSES	102,619,039	93,692,519
PREMIUM TAX EXPENSE	23,436,724	-
TOTAL EXPENSES	1,303,327,187	1,132,255,334
OPERATING INCOME	9,662,295	30,267,397
NONOPERATING INCOME		
Investment income	3,085	2,575
Unrealized losses on investments	(1,924)	(208)
TOTAL NONOPERATING INCOME	1,161	2,367
CHANGE IN NET ASSETS PRIOR TO CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	9,663,456	30,269,764
CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT	(1,449,518)	(4,540,469)
CHANGE IN NET ASSETS	8,213,938	25,729,295
NET ASSETS, BEGINNING OF YEAR	121,933,441	96,204,146
NET ASSETS, END OF YEAR	$ 130,147,379	$ 121,933,441

See Notes to Financial Statements

MERCY MARICOPA INTEGRATED CARE

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets prior to change in net assets attributable to District	$ 9,663,456	$ 30,269,764
Adjustments to reconcile change in net assets prior to change in net assets attributable to District to net cash provided by operating activities:		
Amortization expense	769,083	769,083
Provision for bad debts	254,404	-
Net unrealized losses on investments	1,960	208
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Reinsurance receivables	-	445,836
Pharmacy rebate receivables	1,156,226	(878,233)
Provider advances	(1,232,157)	415,611
Other accounts receivable	(967,539)	405,166
Risk share settlement	1,095,606	(325,839)
Due from AHCCCS	9,019,110	3,662,824
Due from Aetna	1,376,570	(1,266,095)
Prepaid assets	6,305,102	(6,596,102)
Increase (decrease) in:		
Claims payable	8,128,130	(17,019,457)
Payable to providers	2,519,227	12,350,615
Due to AHCCCS	(20,466,400)	36,039,936
Deferred revenue	(1,872,316)	5,443,038
Other current liabilities	(1,153,530)	2,012,964
Net cash provided by operating activities	14,596,932	65,729,319
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of restricted securities	520,000	520,000
Purchase of restricted securities	(440,000)	(520,000)
Net cash provided by investing activities	80,000	-
NET CHANGE IN CASH AND CASH EQUIVALENTS	14,676,932	65,729,319
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	235,239,030	169,509,711
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 249,915,962	$ 235,239,030

See Notes to Financial Statements

(1) Organization operations and significant accounting policies

Organization operations - Effective January 22, 2013, ***Mercy Maricopa Integrated Care*** (Mercy Maricopa or the Organization), was incorporated in the State of Arizona with a dissolution date of the later of December 31, 2021 or six months after the expiration of the Regional Behavioral Health Authority (RBHA) contract. The initial members of Mercy Maricopa are Southwest Catholic Health Network Corporation dba Mercy Care Plan (SCHN), Dignity Health (Dignity), Carondelet Health Network (Carondelet), and Maricopa County Special Health Care District (District). The by-laws provide that Mercy Maricopa shall have one class of members initially; however, the current members may decide to create additional classes of membership or to add new members with unanimous consent of existing members. Relative interests of the members and the formula for distributions to members effective September 9, 2013 is as follows:

SCHN	85%
District	15%

The agreements also provide that SCHN serve as the managing member of Mercy Maricopa.

The Organization was formed to provide physical and behavioral health care services on an integrated basis to Medicaid eligible adults with serious mental illness, and to operate as the RBHA to coordinate the delivery of health care services to eligible persons in Maricopa County, Arizona. Mercy Maricopa was initially funded through a $30 million capital contribution from SCHN and a $10 million capital contribution from District. SCHN contributed additional capital totaling $25 million during each of the years ended June 30, 2015 and 2014. No additional capital contributions were made during the years ended June 30, 2016 or 2017.

On March 25, 2013, Mercy Maricopa was awarded a $3 billion three year contract with the Arizona Department of Health Services (ADHS) to serve as the designated RBHA for the geographical service area (GSA) of Maricopa County. This new contract was to take effect October 1, 2013; however, the prior contract holder filed a legal challenge and requested and received a stay order requiring the contract to remain with the prior contract holder until the legal challenge had been decided. On December 3, 2013, the Deputy Director of the Arizona Department of Administration issued an Order affirming the Arizona Department of Health Services award of the GSA 6 Integrated Care RBHA contract to Mercy Maricopa effective April 1, 2014. Effective July 1, 2016 the contract with ADHS was transferred to the Arizona Health Care Cost Containment System (AHCCCS). The Organization’s contract with AHCCCS has been renewed through September 30, 2020.

Mercy Maricopa is responsible for managing and maintaining an organized, comprehensive integrated healthcare delivery system for the benefit of eligible members within its assigned geographical service area.

The Organization also operated a Medicare Advantage Plan (Medicare Advantage) with the Centers for Medicare and Medicaid Services (CMS), offering medical and prescription drug benefits to qualified members. Medicare Advantage operated as a special needs plan under CMS guidelines. The populations covered under Medicare Advantage were members who were eligible for both Medicare and Medicaid coverage. Mercy Maricopa did not renew its Medicare Advantage Plan with CMS and discontinued the plan effective December 31, 2015. For the year ended June 30, 2016, capitation revenue for the Medicare Advantage Plan was approximately $13,800,000 and the net income of the program was approximately $3,400,000. The results of the Medicare Advantage Plan were minimal during fiscal year 2017 through the closure of the claims window on June 30, 2017.

(1) Organization operations and significant accounting policies (continued)

The Organization entered into a five year management agreement with Aetna effective May 1, 2013. The agreement automatically renews for a second five year term and thereafter for successive one-year periods. SCHN also contracts with Aetna separately to provide management services. Under the terms of Mercy Maricopa's management agreement, the Organization pays a monthly fee to Aetna, as defined in the agreement, to cover the employee salary and benefit costs and general and administrative expenses incurred to operate the Organization. Mercy Maricopa incurred management fees per the management agreement of $98,856,304 and $89,257,837 for the years ended June 30, 2017 and 2016, respectively. These amounts are included in general and administrative expenses in the accompanying statements of activities and changes in net assets. At June 30, 2017 and 2016, as a result of the timing of payments and the estimation process, Mercy Maricopa had overpaid management fees to Aetna and was owed $74,055 and $1,348,642, respectively, which is included in Due from Aetna in the accompanying statements of financial position.

The significant accounting policies followed by the Organization are summarized below:

Basis of presentation - The accompanying financial statements have been prepared in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 954-205, *Health Care Entities – Presentation of Financial Statements*. The Organization's financial statements are also presented in accordance with FASB ASC 958-205, *Not-for-Profit Entities – Presentation of Financial Statements.* Under FASB ASC 958-205, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. As of June 30, 2017 and 2016, there were no temporarily restricted or permanently restricted net assets.

Management's use of estimates - The preparation of the 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate particularly susceptible to change in the near term relates to the claims payable liability.

Cash and cash equivalents - Cash includes cash deposits in banks and cash equivalents. Mercy Maricopa considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Amounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC).

Revenue recognition - Mercy Maricopa receives substantially all of its revenue from its contract with AHCCCS. Operating revenue includes funding in the form of capitation revenue, which is recognized over the applicable coverage period on a per member basis for covered members. Under this arrangement, the Organization is paid a per member fee for all enrolled members, and this fee is recorded as revenue in the month in which members are entitled to services. Any fees received prior to the month of service are recorded as deferred revenue. Capitation revenues from AHCCCS totaled $1,171,836,212 and $1,010,040,676 for the years ended June 30, 2017 and 2016, respectively. Capitation revenues from CMS totaled $13,779,903 for the year ended June 30, 2016. No capitation revenue was earned from CMS for the year ended June 30, 2017.

The AHCCCS contract is partially funded by federal, state, county and block grants (non-title revenue), which represent annual appropriations. Mercy Maricopa recognizes revenue from this funding ratably over the period to which the funding applies. Non-Title revenues, including block grants, totaled $141,212,612 and $138,756,545 for the years ended June 30, 2017 and 2016, respectively.

(1) Organization operations and significant accounting policies (continued)

The AHCCCS contract revenue is also limited by the terms of the AHCCCS contract to a maximum profit percentage of four percent. Effective July 1, 2016, the maximum profit percentage was decreased to one percent. As of June 30, 2016, AHCCCS contract revenue that could not be recognized due to the profit limits for the contract period of April 1, 2014 through September 30, 2015 totaled $16,884,353. As of June 30, 2017, this payable decreased to $12,412,226 as a result of further runout of claims.

AHCCCS contract revenue that could not be recognized due to the profit limit for the contract year October 1, 2015 through September 30, 2016 as of June 30, 2016 totaled $19,272,601. As of June 30, 2017, the amount due to AHCCCS was $0.

AHCCCS contract revenue that could not be recognized due to the profit limit for the contract year October 1, 2016 through September 30, 2017 as of June 30, 2017 was estimated to be $3,278,328.

These amounts are included in Due to AHCCCS on the accompanying statements of financial position and represent a reduction in operating revenue.

Due from AHCCCS - At June 30, 2017 and 2016, due from AHCCCS consists primarily of amounts due for the provisions of housing and other services and for capitation payments under the Organization’s contract. The receivables are stated at the amount management expects to collect. The Organization establishes an allowance for doubtful accounts, if necessary, based upon factors including credit risk, historical trends, and other information. As of June 30, 2017 and 2016, amounts due from AHCCCS are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Reinsurance revenue - The Organization contracts with a commercial reinsurer to provide reinsurance for the Medicare Advantage Plan to provide a stop-loss reinsurance program for partial reimbursement of reinsurable covered medical services incurred for members. The program includes a deductible of $500,000 and has an annual reinsurance limit of $2,000,000 per member. The commercial reinsurer reimburses the Organization based on a coinsurance amount for reinsurable covered services incurred above the deductible of 90%. Reinsurance revenue is stated at the actual and estimated amounts due to the Organization pursuant to the Medicare Advantage Plan contract. For the year ended June 30, 2016, as a result of current year claim adjustments, Mercy Maricopa recognized a net reinsurance expense of $54,393. For the year ended June 30, 2017, there was no reinsurance revenue recognized.

Pharmacy rebates receivable - Mercy Maricopa receives rebates from pharmaceutical companies based on the volume of drugs purchased. Mercy Maricopa records a receivable and a reduction of health care expenses for estimated rebates due based on purchase information. During the years ended June 30, 2017 and 2016, health care expenses were reduced by $399,268 and $4,124,077 for rebates, respectively. Rebates have decreased primarily due to the termination of the Medicare Advantage contract effective December 31, 2015. At June 30, 2017 and 2016, management believes the pharmacy rebate receivables are fully collectible and accordingly, an allowance has not been established.

(1) Organization operations and significant accounting policies (continued)

Provider advances - Upon request, Mercy Maricopa, in accordance with AHCCCS contract limitations, may advance monies to high-volume providers based on cash flow needs and timing of claims payments. Advances are stated at the amount management expects to collect or offset against future claims. Advances are non-interest bearing and are expected to be settled within 12 months. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to provider advances receivable. As of June 30, 2017, provider advances receivable are net of an allowance for doubtful accounts of $207,132. As of June 30, 2016, provider advances receivable was considered by management to be fully collectible and accordingly, an allowance for doubtful accounts had not been provided.

Risk share settlement - The risk share settlement includes expected payments to be paid to or received from CMS in connection with the pharmacy component of Medicare Advantage, Medicare Part D. This balance is reviewed and monitored by management and adjusted as necessary as experience develops or new information becomes available. Such adjustments are netted against revenues on the statements of activities and changes in net assets. Amounts earned under this program totaled $0 and $1,095,606 for the years ended June 30, 2017 and 2016, respectively, which are included in risk share settlement receivables and revenues in the accompanying financial statements. A preliminary settlement was received in May 2017, satisfying the receivable recorded as of June 30, 2016. The risk share settlement program ended with the termination of the Medicare Advantage contract on December 31, 2015.

Restricted securities - Mercy Maricopa accounts for its investments in accordance with FASB ASC 958-320, *Not-for-Profit Entities – Investments – Debt and Equity Securities*. Under FASB ASC 958-320, Mercy Maricopa is required to report investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. The fair value of investments is based on quoted market prices. At June 30 2016, restricted securities consists of U.S. Treasury notes held by a bank required to remain in trust by the State of Arizona, Department of Insurance (ADOI) for the duration of the Organization's contract with AHCCCS. As of March 2017, this security was no longer required due to the surrender of Mercy Maricopa's Health Care Services Organization license with ADOI. The ADOI did require a security deposit for remaining claims on the Medicare Advantage Plan. At June 30, 2017, the security deposit consists of a U.S. Treasury note held by a bank in trust by the State of Arizona. The Organization may not make withdrawals on the account without prior approval from the ADOI. The purchases and sales of restricted securities are recorded on a trade-date basis. Interest is recognized on the accrual basis.

Healthcare service cost recognition - Mercy Maricopa contracts with various providers for the provision of a full range of integrated healthcare services to eligible adults and children for Title XIX, Title XXI, and Non-Title programs, and physical healthcare services to Seriously Mental Ill Title XIX eligible adults. Healthcare services are purchased under fee-for-service or block purchase arrangements. Fee-for-service contract expenses are accrued as incurred. Healthcare services provided under block purchase arrangements are accrued based upon contract terms. From time to time, Mercy Maricopa amends the provider contracts. The effects of these amendments are recorded in the period in which the amendment was executed.

The estimate for claims payable is developed using actuarial methods based on enrollment data, utilization statistics, and authorized health care services. The estimate for claims payable is continually reviewed by management and adjusted as necessary based on current claims data, and medical cost completion factors. Such adjustments are included in health care expenses in the statements of activities and changes in net assets in each period when necessary. While management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. There is at least a reasonable possibility that the recorded estimates will change by a material amount, in the near future.

(1) Organization operations and significant accounting policies (continued)

As part of AHCCCS' Value-Based Purchasing Initiative, and in accordance with the AHCCCS Contract, Mercy Maricopa has agreements with certain providers that provide for the establishment of a pool into which Mercy Maricopa places funds based on the performance of the provider as defined in the contract. Mercy Maricopa manages the disbursement of the funds from this account as well as reviews the utilization and designated quality scores based on members assigned to the provider. Mercy Maricopa accrued $10,742,925 and $7,503,069 for the Value-Based Purchasing Initiative payable to providers as of June 30, 2017 and 2016, respectively, which are included in payable to providers in the accompanying statements of financial position.

Premium deficiency reserve - Mercy Maricopa evaluates possible losses on its contracts through the end of each contract year. If necessary, a premium deficiency reserve is recorded within claims payable on the statements of financial position. Mercy Maricopa has no estimated amounts recorded for premium deficiency reserves as of June 30, 2017 and 2016.

Expense allocation - Certain direct and indirect administrative expenses are incurred which benefit more than one program. Such common expenses are allocated based upon an AHCCCS approved cost allocation plan as submitted by Mercy Maricopa, which is primarily based upon enrollment, claims and costs by lines of business.

Payable to providers - Mercy Maricopa compensates providers for authorized healthcare and substance abuse services to covered beneficiaries. Mercy Maricopa uses a variety of methods to estimate the amount payable to providers including authorizations for services to be provided, payments to be made under contract arrangements currently in force, and correspondence with significant providers to ascertain the level of care being provided to beneficiaries for which a claim has not yet been submitted.

Capitalized software costs - Research and development costs are charged to expense as incurred. However, the costs incurred for the development or purchase of computer software that relate to the implementation of the claims processing system are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated useful lives and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when the product is available for release and installation. Amortization is provided on a straight-line method over periods not exceeding five to seven years. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product is expensed immediately. Capitalized software cost totaled $3,845,414 at June 30, 2017 and 2016. Effective April 1, 2014, the software was completed and placed into service, at which time Mercy Maricopa commenced amortization. Amortization expense totaled $769,083 for each of the years ended June 30, 2017 and 2016. Accumulated amortization was $2,499,519 and $1,730,436 as of June 30, 2017 and 2016, respectively.

(1) Organization operations and significant accounting policies (continued)

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 by requiring 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.

U.S. Treasury notes are valued using proprietary models incorporating live data from active market makers and inter-dealer brokers as reported on electronic communication networks. The valuation models incorporate benchmark yields, reported trades, broker/dealer quotes, bids, offers and other data. These valuation inputs are considered Level 2.

Income taxes - Mercy Maricopa qualifies as a tax exempt organization under Section 501(c)(3) of the Internal Revenue Code (the Code) and, therefore, there is no provision for income taxes included in the accompanying financial statements. Income determined to be unrelated business taxable income would be taxable.

FASB ASC 740-10, *Income Taxes*, relates to the accounting for uncertainty in income taxes which requires the application of a “more likely than not” threshold recognition and de-recognition of uncertain tax positions in operations in the year of such change. The Organization evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax flings, and discussions with outside experts. At June 30, 2017 and 2016, the Organization did not have any uncertain tax positions.

Mercy Maricopa’s Federal Exempt Organization Business Income Tax Returns (Form 990) for 2014, 2015, and 2016 are subject to examination by the IRS, generally for the three years after they were filed. As of the date of this report, the fiscal 2017 tax returns had not yet been filed.

Mercy Maricopa is subject to a 2% premium tax on all payments received from AHCCCS for premiums, reinsurance, and reconciliations. Prior to July 1, 2016, the premium tax was withheld from Mercy Maricopa’s contract payments and remitted direct to the ADOI. Subsequent to July 1, 2016, premium taxes are no longer being withheld from Mercy Maricopa’s contract payments and Mercy Maricopa must remit the premium taxes directly to the ADOI. Premium tax expense for the year ended June 30, 2017 totaled $23,436,724. At June 30, 2017, premium tax payable totaled $443,891 and is included in other current liabilities in the accompanying statement of financial position.

Performance indicator - The statements of activities and changes in net assets includes the performance indicator operating income. The performance indicator excludes nonoperating income and net unrealized investment losses, which is consistent with industry practice.

(1) Organization operations and significant accounting policies (continued)

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. The Organization is currently evaluating the full effect that the adoption of this standard will have on the financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows* (*Topic 230*). This ASU requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in the ASU do not provide a definition of restricted cash or restricted cash equivalents. The ASU is effective for all nonpublic business entities for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Organization is evaluating the full effect that the adoption of this standard will have on the financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 improves the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. ASU 2016-14 is effective for annual financial statements issued for fiscal years beginning after December 15, 2017. Early adoption is permitted. The amendments of this ASU are to be applied on a retrospective basis in the year that the ASU is first applied. The Organization is currently evaluating the full effect that the adoption of this standard will have on the financial statements.

(1) Organization operations and significant accounting policies (continued)

In January 2015, the FASB issued ASU No. 2016-01*, Financial Instruments - Overall (Subtopic 825-10).* ASU 2016-01 requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). ASU 2016-01 also requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, ASU 2016-01 eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the statement of financial position for public business entities. The amendments in ASU 2016-01 are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in ASU 2016-01 earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early application by public business entities to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of the following amendments in this Update are permitted as of the beginning of the fiscal year of adoption:

1. An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
2. Entities that are not public business entities are not required to apply the fair value of financial instruments disclosure guidance in the General Subsection of Section 825-10-50.

The Organization adopted ASU 2016-01 as of June 30, 2016 relative to the requirement to apply the fair value of financial instruments disclosure guidance in the General Subsection of Section 825-10-50.

Subsequent events - The Organization has evaluated subsequent events through October 25, 2017, which is the date the financial statements were available to be issued.

(2) Claims payable

At June 30, 2017 and 2016 claims outstanding to third parties for health care services provided to members, including estimates for incurred but not reported claims, were approximately $66 million and $57 million, respectively. The balances at June 30, 2017 and 2016 were certified by an actuary. Activity in the liability for claims payable and health care expense for the years ended June 30, 2017 and 2016 is as follows:

	2017	2016
Balance at July 1	$ 57,413,366	$ 74,432,823
Incurred related to:		
Current year	573,773,840	509,707,130
Prior years	15,180,946	(20,514,737)
Total incurred	588,954,786	489,192,393
Paid related to:		
Current year	(518,449,116)	(463,976,679)
Prior years	(62,377,540)	(42,235,171)
Total paid	(580,826,656)	(506,211,850)
Balance at June 30	$ 65,541,496	$ 57,413,366

(2) Claims payable (continued)

Estimates for incurred claims are based on historical enrollment, cost trends, and consider operational changes. Future actual results will typically differ from the estimates. Differences could be due to factors such as an overall change in medical expenses per member or a change in client mix affecting medical costs due to the addition of new members.

The liability for claims payable at June 30, 2016 was less than the actual claims incurred related to fiscal year 2016 and prior by approximately $6.8 million or 12%. The primary drivers for unfavorable claim development include member mix changes and higher than anticipated member utilization. Mercy Maricopa continues to incur claims for prior periods. The claims payable is adjusted each period end as more information becomes available.

(3) Due to/from District

During the period from formation (January 22, 2013) through June 30, 2013, District contributed $5 million towards the initial funding of the Organization. Additionally, in accordance with a promissory note agreement between Mercy Maricopa and District dated September 9, 2013, District agreed to pay Mercy Maricopa an additional $5 million for a total of $10 million contributed. The promissory note was due April 1, 2015, one year after the implementation of the RBHA contract for GSA 6 awarded to Mercy Maricopa. The promissory note bore no interest through the maturity date and was unsecured. All amounts were collected in full as of June 30, 2015.

In accordance with the membership agreement, any time after three years from the commencement of the RBHA contract (April 1, 2014), District may require that Mercy Maricopa purchase the membership interest of District. The purchase price of District's membership interest under the District put option shall be the sum of District's capital contributions to Mercy Maricopa, without interest, and any remaining accrued or deferred distributions to District (a 15% relative interest), plus interest, if any. As a result of the put option within the membership agreement, $18,849,539 (the $10 million, plus District's share of the changes in Mercy Maricopa's net assets since formation of $8,849,539) and $17,400,021 is included in Due to District, within the accompanying statements of financial position at June 30, 2017 and 2016, respectively.

In accordance with the membership agreement, payment to District for its Membership Interest under the District put option shall be made, at the option of Mercy Maricopa, either in cash at closing, or by payment of all remaining accrued or deferred distributions to District, plus interest, at closing, along with repayment of fifty percent (50%) of District's capital contributions, with the balance represented by a promissory note, secured by the assets of the Corporation (whether the Corporation or the Non-Public Members is the purchaser) and payable in one (1) year, with interest on the unpaid balance at the JPMorgan Chase "prime rate," or such other rate as may be unanimously agreed upon by the Members. Accordingly, based on the membership agreement and management's intent, the entire balance owed to District has been classified in the accompanying statement of financial position as a current liability at June 30, 2017 and 2016.

(4) Related party transactions

The Organization paid $8,690,333 in 2017 and $8,354,918 in 2016 to Dignity and its affiliates, $681,578 in 2017 and $673,696 in 2016 to Carondelet and its affiliates and $56,827,380 in 2017 and $42,781,839 in 2016 to District for behavioral health and other medical services provided to its members.

(5) Commitments and contingencies

Performance bonds - In accordance with the terms of its contract with AHCCCS, Mercy Maricopa is required to post a performance bond with AHCCCS equal to 80% of the expected monthly Title capitation and Non-Title 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 performance bond must be maintained to guarantee payment of Mercy Maricopa's obligations under the contract. The performance bond requirement was $72,100,000 for the year ended June 30, 2016. Effective October 1, 2016 the performance bond requirement was increased to $82,341,799 and was met through the purchase of three performance bonds totaling $82,500,000 at June 30, 2017, which expire September 30, 2018.

Litigation - Periodically, the Organization is 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. Management believes that any resulting liability, if any, will not materially affect the Organization's financial position.

Liability insurance - Mercy Maricopa maintains directors and officers, errors and omissions, and cyber liability insurance coverage under claims-made policies. Mercy Maricopa is insured for losses up to $20 million per claim and in the aggregate under its directors and officers liability policy. Mercy Maricopa is insured for losses up to $10 million per claim and in the aggregate under each of its errors and omissions and cyber liability policies. Claims reported endorsement (tail) coverage is available if the policy is not renewed to cover claims incurred but not reported.

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 Organization 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 reviews 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 Organization does business, restrict revenue and enrollment growth in certain products and market segments, restrict growth rates for certain products and market segments, increase medical, administrative and capital costs, and expose the Organization to increased risk of loss or further liabilities. The Organization's operating results, financial position and cash flows could be adversely impacted by such changes.

Community reinvestment program - In accordance with the AHCCCS contract, Mercy Maricopa has approved a Community Reinvestment program. Under the program, Mercy Maricopa will place 5% of its total change in net assets for the purposes of community reinvestment. The program funds community projects that enhance the lives of people in the communities in Mercy Maricopa's geographic service area. These funds are for projects and services not eligible for service or prevention dollars from Mercy Maricopa.

For the years ended June 30, 2017 and 2016, Mercy Maricopa approved amounts that resulted in expenses of $481,506 and $1,328,012, respectively, to be spent on various healthcare community projects. These amounts are included in general and administrative expenses in the accompanying statements of activities and changes in net assets. At June 30, 2017 and 2016, Mercy Maricopa had not yet spent all of the funds appropriated. Accordingly, at June 30, 2017 and 2016, Mercy Maricopa has recorded a liability for unspent Community Reinvestment program funds of $2,517,142 and $3,395,215, respectively, which is included in other current liabilities.

(6) Contract requirements

In accordance with the AHCCCS contract, the Organization is required to maintain certain minimum financial reporting and viability measures.

The Organization must maintain unrestricted minimum capitalization of at least 90% of the monthly capitation and block payments received under the Contract. As of June 30, 2017, the Organization was in compliance with this requirement.

The Contract contains various quarterly financial performance requirements, including a required minimum liquidity ratio, an administrative cost percentage, and service expense percentages. As of June 30, 2017, the Organization was in compliance with these requirements.

As discussed in Note 1, the Organization is limited by the terms of its contract with AHCCCS to profit that can be earned under the various programs.

Should the Organization be in default of any material obligations under the Contract, AHCCCS may, at its discretion, in addition to other remedies, either adjust the amount of future payments or withhold future payment until satisfactory resolution of the default or exception. Further, if monies are not appropriated by the State or are not otherwise available, the Contract may be cancelled upon written notice until such monies are so appropriated or available.

Mercy Maricopa is required to meet quarterly and contract year end minimum encounter submission percentages, or be subject to sanction by AHCCCS. Typically, Mercy Maricopa has up to eight months after the contract period end to meet the minimum number of encounters. For the year ended June 30, 2016, Mercy Maricopa anticipated meeting the required encounter threshold for the contract period from October 1, 2015 through September 30, 2016. Accordingly as of June 30, 2016, Mercy Maricopa did not record a liability associated with an encounter sanction. Through the date of this report, AHCCCS has not yet completed its encounter evaluation assessment for the contract year ended September 30, 2016. However, management continues to anticipate meeting the required encounter threshold. As of June 30, 2017, Mercy Maricopa anticipates meeting the required encounter threshold for the contract period from October 1, 2016 through September 30, 2017. Accordingly, as of June 30, 2017, Mercy Maricopa has not recorded a liability associated with an encounter sanction.

AHCCCS has a right to sanction Mercy Maricopa for other matters of non-compliance of the Contract, as determined by AHCCCS. Mercy Maricopa received sanctions of $0 and $22,198 from AHCCCS for the years ended June 30, 2017 and 2016, respectively. Sanctions are included in Mercy Maricopa’s management agreement with Aetna and as such, no additional expense is reflected in the accompanying financial statements.

(7) Concentration of credit risk

Mercy Maricopa currently holds a contract with AHCCCS to provide services through September 30, 2020. Failure to renew this contract could have a significant impact on operations.

ADDITIONAL INFORMATION

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INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

To the Board of Directors of

MERCY MARICOPA INTEGRATED CARE

We have audited, the financial statements of ***Mercy Maricopa Integrated Care*** as of and for the years ended June 30, 2017 and 2016, and our report thereon dated October 25, 2017, which contained an unmodified opinion on those financial statements, appears on pages 1 - 2. Our audits were performed for the purpose of forming an opinion on the financial statements as a whole. The additional information on page 18 is presented for purposes of additional analysis and is not a required part of the financial statements. The Sub-Capitated Expenses report is required in accordance with the Arizona Health Care Cost Containment System contract. The additional information on page 18 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 audits 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 of America. In our opinion, the additional information is fairly stated in all material respects in relation to the financial statements as a whole.

Mayer Hoffman McCann P.C.

October 25, 2017

MERCY MARICOPA INTEGRATED CARE

ADDITIONAL INFORMATION

SUB-CAPITATED EXPENSES REPORT

Year Ended June 30, 2017

Account	Account Description		
Sub-Capitated Behavioral Health Expenses:			
501d	Total Treatment Services	$	81,762,014
502e	Total Rehabilitation Services		63,830,681
503e	Total Medical Services	$	34,515,372
504j	Total Support Services		151,778,842
505d	Total Crisis Intervention Services		73,918,144
506e	Total Inpatient Services		10,096,610
507d	Total Residential Services		13,329,444
508d	Total Behavioral Health Day Program		5,029,468
509c	Total Prevention Services		1,105,062
510d	Total Pharmacy Expense		-
511	Other Service Expenses not Reported Above		111,386
512	BH FQHC/RHC Services		-
	Total Sub-Capitated Behavioral Health Expenses:	$	435,477,023
Sub-Capitated Hospitalization Expenses:			
402	Hospital Inpatient	$	67,657
404	Hospital Inpatient, BH Principal Diagnosis		-
406	Hospital Inpatient, PPC		-
	Total Sub-Capitated Hospitalization Expenses:	$	67,657
Sub-Capitated Medical Compensation Expenses:			
408	Primary Care Physician Services	$	-
409	Physician Services, BH Principle Diagnosis		-
410	Referral Physician Services		-
411	PH FQHC/RHC Services		-
412	Other Professional		-
414	PPC-Physician Services		-
415	PCP Parity Enhanced Payment Expense		-
	Total Sub-Capitated Medical Compensation Expenses:	$	-
Sub-Capitated Other Medical Expenses:			
416	Emergency Facility Services	$	-
417	Pharmacy		-
	less: Pharmacy Rebates		-
418	Lab, X-ray, & med image		-
419	Outpatient Facility		-
420	Durable Med Equip		-
421	Dental		-
422	Transportation		-
423	Nursing Facility, Home Health Care		-
424	Physical Therapy		-
434	Value Based Purchasing Provider Expenses		-
425	Miscellaneous Medical Expenses		-
438	Miscellaneous Medical Expenses, PPC		-
	Total Sub-Capitated Other Medical Expenses:	$	-
	Total Sub-Capitated Expenses:	$	435,544,680

UNIFORM GUIDANCE
SUPPLEMENTAL REPORTS

MERCY MARICOPA INTEGRATED CARE

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2017

Federal Grantor / Pass-Through Grantor / Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Passed Through to Subrecipients	Federal Expenditures
U.S. Department of Health and Human Services Pass-through Programs From:				
Arizona Health Care Cost Containment System:				
Block Grants for Prevention and Treatment of Substance Abuse	93.959	11356415170214	$ 14,143,672	$ 15,417,914
Block Grants for Community Mental Health Services				
SMI - Non-Title XIX	93.958	11356415170214	2,806,511	2,988,000
Children - Non-Title XIX	93.958	11356415170214	1,711,162	1,929,615
Subtotal Block Grants for Community Mental Health Services (93.958)			4,517,673	4,917,615
Substance Abuse and Mental Health Services, Projects of Regional and National Significance	93.243	11356415170214	-	377,091
Total Passed-Through Arizona Health Care Cost Containment System			18,661,345	20,712,620
Centers for Medicare and Medicaid Services (CMS) and Arizona Heath-e Connection				
ACA - Transforming Clinical Practice Initiative: Practice Transformation Networks (PTNs)	93.638	68660047917631	-	248,321
Total U.S. Department of Health and Human Services			18,661,345	20,960,941
TOTAL EXPENDITURES OF FEDERAL AWARDS			$ 18,661,345	$ 20,960,941

See Independent Auditors' Report

See Accompanying Notes to the Schedule of Expenditures of Federal Awards

MERCY MARICOPA INTEGRATED CARE

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2017

(1) <u>Basis of presentation</u>

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of ***Mercy Maricopa Integrated Care*** under programs of the federal government for the year ended June 30, 2017. The information in the Schedule is presented in accordance with the requirements of *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"). Because the Schedule presents only a selected portion of the operations of ***Mercy Maricopa Integrated Care***, it is not intended to and does not present the financial position, changes in net assets or cash flows of ***Mercy Maricopa Integrated Care***.

(2) <u>Summary of significant accounting policies</u>

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. ***Mercy Maricopa Integrated Care*** has not elected to use the ten percent de minimis indirect cost rate allowed under the Uniform Guidance.

(3) <u>Catalog of Federal Domestic Assistance (CFDA) numbers</u>

The program titles and CFDA numbers were obtained from the 2017 Catalog of Federal Domestic Assistance.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of

MERCY MARICOPA INTEGRATED CARE

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of ***Mercy Maricopa Integrated Care*** (the "Organization"), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 25, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ***Mercy Maricopa Integrated Care's*** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ***Mercy Maricopa Integrated Care's*** internal control. Accordingly, we do not express an opinion on the effectiveness of ***Mercy Maricopa Integrated Care's*** internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described as Item 2017-001 in the accompanying schedule of findings and questioned costs that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ***Mercy Maricopa Integrated Care's*** financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Mercy Maricopa Integrated Care's Response to the Finding

Mercy Maricopa Integrated Care's response to the finding identified in our audit is described in the accompanying schedule of findings and questions costs. ***Mercy Maricopa Integrated Care's*** response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of ***Mercy Maricopa Integrated Care's*** internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ***Mercy Maricopa Integrated Care's*** internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Mayer Hoffman McCann P.C.

October 25, 2017

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Board of Directors of

MERCY MARICOPA INTEGRATED CARE

Report on Compliance for Each Major Federal Program

We have audited ***Mercy Maricopa Integrated Care's*** compliance with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") Compliance Supplement that could have a direct and material effect on each of ***Mercy Maricopa Integrated Care's*** major federal programs for the year ended June 30, 2017. ***Mercy Maricopa Integrated Care's*** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of ***Mercy Maricopa Integrated Care's*** major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about ***Mercy Maricopa Integrated Care's*** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of ***Mercy Maricopa Integrated Care's*** compliance.

Opinion on Each Major Federal Program

In our opinion, ***Mercy Maricopa Integrated Care*** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

Report on Internal Control Over Compliance

Management of ***Mercy Maricopa Integrated Care*** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered ***Mercy Maricopa Integrated Care's*** internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of ***Mercy Maricopa Integrated Care's*** internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over* compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Mayer Hoffman McCann P.C.

October 25, 2017

MERCY MARICOPA INTEGRATED CARE

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year Ended June 30, 2017

Section I – Summary of Auditors' Results

Financial Statements

1. Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:	Unmodified
2. Internal control over financial reporting:	
a. Material weakness(es) identified?	No
b. Significant deficiency(ies) identified?	Yes
3. Noncompliance material to financial statements noted?	No

Federal Awards

1. Internal control over major federal programs:	
a. Material weakness(es) identified?	No
b. Significant deficiency(ies) identified?	None reported
2. Type of Auditor's report issued on compliance for major federal programs:	Unmodified
3. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	No
4. Identification of major federal programs:	

CFDA Number	Name of Federal Program or Cluster
93.958	Block Grants for Community Mental Health Services
93.959	Block Grants for Prevention and Treatment of Substance Abuse

5. Dollar threshold used to distinguish between type A and type B programs:	$750,000
6. Auditee qualified as a low-risk auditee?	Yes

MERCY MARICOPA INTEGRATED CARE

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year Ended June 30, 2017

Section II – Financial Statement Findings

Item: **2017-001**

Subject: Misstatement of provider incentive liability and expense

Criteria: Accounting principles generally accepted in the United States of America require that liabilities and expenses be stated at the amount management expects to incur.

Condition: ***Mercy Maricopa Integrated Care's*** financial statements include a misstatement of the provider incentive liability which has not been corrected by management, as the amount was not deemed to be material to ***Mercy Maricopa Integrated Care*** management.

As part of ***Mercy Maricopa Integrated Care's*** contracts with providers, ***Mercy Maricopa Integrated Care*** has agreed to pay providers certain incentives based on the performance of the provider, as defined in the contract. Incentive awards are based on utilization and designated quality scores based on member assigned to the provider. During the year ended June 30, 2017, certain errors were identified in the estimation of the provider incentive liabilities. The errors resulted from inadequate internal controls surrounding the evaluation of the provider incentives and communication between the group responsible for estimating the provider incentives and the accounting and financial reporting team. This is deemed to be a significant deficiency in internal controls.

Context: The provider incentive liability recorded in the financial statements has not been reconciled to the detail supporting the estimate by management. The final determination of the amount of incentives earned by providers was not evaluated timely and required corrections to the original estimate presented during the audit.

Effect: The provider incentive liability and related expenses in the ***Mercy Maricopa Integrated Care*** financial statements as of and for the year ended June 30, 2017 are overstated by $2,658,728. This amount was not corrected, as the amount was determined by management to be immaterial to the financial statements.

Cause: The misstatement was the result of a lack of communication between the group responsible for measuring and tracking the incentives earned by providers and the accounting and financial reporting team within the Organization.

Recommendation: We recommend that ***Mercy Maricopa Integrated Care*** establish policies and procedures to include a quarterly calculation and review of all provider incentives to assess what amounts have been earned by the providers and should be accrued. We also recommend that the group responsible for determining the provider incentives meet with the accounting and financial reporting group at least quarterly to ensure the Organization is properly recording provider incentive expense and liabilities based on management's best estimates of amounts earned and due to the providers for incentives.

Views of responsible officials and planned corrective actions: Management of ***Mercy Maricopa Integrated Care*** concurs with the finding. See Corrective Action Plan below.

Section III – Federal Award Findings

None noted

Corrective Action Plan and Summary Schedule of Prior Audit Findings

Corrective Action Plan

Item:	**2017-001**
Criteria or Specific Requirement:	Accounting principles generally accepted in the United States of America require that liabilities and expenses be stated at the amount management expects to incur.
Condition:	***Mercy Maricopa Integrated Care's*** financial statements include a misstatement of the provider incentive liability which has not been corrected by management, as the amount was not deemed to be material to ***Mercy Maricopa Integrated Care*** management. As part of ***Mercy Maricopa Integrated Care's*** contracts with providers, ***Mercy Maricopa Integrated Care*** has agreed to pay providers certain incentives based on the performance of the provider, as defined in the contract. Incentive awards are based on utilization and designated quality scores based on member assigned to the provider. During the year ended June 30, 2017, certain errors were identified in the estimation of the provider incentive liabilities. The errors resulted from inadequate internal controls surrounding the evaluation of the provider incentives and communication between the group responsible for estimating the provider incentives and the accounting and financial reporting team. This is deemed to be a significant deficiency in internal controls.
Name of Contact Person and Title:	Ramon Dominguez, CFO
Phone Number:	(602) 453-8366
Anticipated Completion Date:	June 30, 2018
Views of Responsible Officials and Corrective Actions:	***Mercy Maricopa Integrated Care*** will establish policies and procedures to include a quarterly calculation and review of all provider incentives to assess what amounts have been earned by the providers and should be accrued. Mercy Maricopa Integrated Care will also conduct quarterly meetings between the group responsible for determining the provider incentives and the accounting and financial reporting group to ensure the Organization is properly recording provider incentive expense and liabilities based on management's best estimates of amounts earned and due to the providers for incentives.

Summary Schedule of Prior Audit Findings

None noted