SOUTHWEST CATHOLIC
HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

CONSOLIDATED FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION

Years Ended June 30, 2014 and 2013
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

We have audited the accompanying consolidated financial statements of Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate, which comprise the consolidated statements of financial position as of June 30, 2014 and 2013, and the related consolidated statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate as of June 30, 2014 and 2013, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Phoenix, Arizona
October 23, 2014
# SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2014 and 2013
(In thousands)

### ASSETS

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$143,567</td>
<td>$108,172</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>17,101</td>
<td>5,260</td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance receivables, net of allowance for doubtful accounts of $4,692 for 2014 and $4,483 for 2013</td>
<td>17,338</td>
<td>32,556</td>
</tr>
<tr>
<td>Reconciliation receivables</td>
<td>19,780</td>
<td>16,491</td>
</tr>
<tr>
<td>Capitation and supplement receivables</td>
<td>69,668</td>
<td>7,767</td>
</tr>
<tr>
<td>Pharmacy rebate receivable</td>
<td>6,624</td>
<td>4,665</td>
</tr>
<tr>
<td>Third-party liability receivable, net of allowance for doubtful accounts of $958 for 2014 and $1,717 for 2013</td>
<td>4,628</td>
<td>5,443</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>655</td>
<td>893</td>
</tr>
<tr>
<td>Provider advances, net of allowance for doubtful accounts of $1,566 for 2014 and $2,323 for 2013</td>
<td>4,647</td>
<td>7,949</td>
</tr>
<tr>
<td>Other receivables</td>
<td>1,503</td>
<td>759</td>
</tr>
<tr>
<td>Risk share settlement</td>
<td>7,288</td>
<td>9,047</td>
</tr>
<tr>
<td>Prepaid assets</td>
<td>1,503</td>
<td>759</td>
</tr>
<tr>
<td>Due from District</td>
<td>7,288</td>
<td>9,047</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT ASSETS</strong></td>
<td>299,349</td>
<td>199,134</td>
</tr>
<tr>
<td><strong>RESTRICTED SECURITIES</strong></td>
<td>521</td>
<td>500</td>
</tr>
<tr>
<td><strong>CAPITALIZED SOFTWARE COSTS, net</strong></td>
<td>3,653</td>
<td>762</td>
</tr>
<tr>
<td><strong>RISK SHARE SETTLEMENT, less current portion</strong></td>
<td>4,061</td>
<td>2,439</td>
</tr>
<tr>
<td><strong>LONG-TERM INVESTMENTS</strong></td>
<td>104,568</td>
<td>166,149</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$412,152</td>
<td>$368,984</td>
</tr>
</tbody>
</table>

### LIABILITIES AND NET ASSETS

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical claims payable</td>
<td>$200,508</td>
<td>$157,277</td>
</tr>
<tr>
<td>Payable to providers</td>
<td>2,966</td>
<td>-</td>
</tr>
<tr>
<td>Reconciliation payable</td>
<td>7,170</td>
<td>17,110</td>
</tr>
<tr>
<td>Due to ADHS/DBHS</td>
<td>707</td>
<td>-</td>
</tr>
<tr>
<td>Due to Aetna</td>
<td>7,005</td>
<td>3,066</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>6,873</td>
<td>9,215</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT LIABILITIES</strong></td>
<td>225,229</td>
<td>186,668</td>
</tr>
<tr>
<td><strong>DUE TO DISTRICT</strong></td>
<td>8,885</td>
<td>4,751</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td>234,114</td>
<td>191,419</td>
</tr>
<tr>
<td><strong>UNRESTRICTED NET ASSETS</strong></td>
<td>178,038</td>
<td>177,565</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES AND NET ASSETS</strong></td>
<td>$412,152</td>
<td>$368,984</td>
</tr>
</tbody>
</table>

See Notes to Consolidated Financial Statements
## SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

### CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2014 and 2013  
(In thousands)

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATING REVENUES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capitation premiums</td>
<td>$1,941,643</td>
<td>$1,615,161</td>
</tr>
<tr>
<td>Delivery supplement</td>
<td>60,073</td>
<td>60,227</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>50,262</td>
<td>51,553</td>
</tr>
<tr>
<td>Other, primarily third party recoveries</td>
<td>2,864</td>
<td>3,486</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING REVENUES</strong></td>
<td><strong>2,054,842</strong></td>
<td><strong>1,730,427</strong></td>
</tr>
</tbody>
</table>

| **HEALTH CARE EXPENSES** |             |             |
| Hospitalization         | 297,088     | 311,576     |
| Medical compensation    | 296,455     | 272,813     |
| Ancillary and other medical services | 909,243 | 662,166 |
| Institutional           | 178,003     | 163,537     |
| Home and community based services | 161,882 | 150,473 |
| **TOTAL HEALTH CARE EXPENSES** | **1,842,671** | **1,560,565** |

| **GENERAL AND ADMINISTRATIVE EXPENSES** |             |             |
|                                         | 160,172     | 124,588     |

| **PREMIUM TAX EXPENSE** |             |             |
|                         | 27,228      | 26,924      |

| **TOTAL EXPENSES** |             |             |
|                    | 2,030,071   | 1,712,077   |

| **OPERATING INCOME** |             |             |
|                      | 24,771      | 18,350      |

| **NONOPERATING INCOME (EXPENSE)** |             |             |
| Investment income      | 17,405      | 11,377      |
| Investment fees        | (1,035)     | (1,024)     |
| **TOTAL NONOPERATING INCOME** | **16,370** | **10,353** |

| **CHANGE IN NET ASSETS PRIOR TO UNREALIZED GAINS (LOSSES) ON INVESTMENTS** |             |             |
|                                                                         | 41,141      | 28,703      |

| **UNREALIZED GAINS (LOSSES) ON INVESTMENTS** |             |             |
|                                               | (1,451)     | 8,029       |

| **CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS AND CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT** |             |             |
|                                                                                               | 39,690      | 36,732      |

| **DISTRIBUTIONS TO SPONSOR ORGANIZATIONS** |             |             |
|                                           | (40,000)    | (40,000)    |

| **CHANGE IN NET ASSETS ATTRIBUTABLE TO DISTRICT** |             |             |
|                                                   | 783         | 249         |

| **CHANGE IN NET ASSETS** |             |             |
|                         | 473         | (3,019)     |

| **NET ASSETS, BEGINNING OF YEAR** |             |             |
|                                   | 177,565     | 180,584     |

| **NET ASSETS, END OF YEAR** |             |             |
|                            | $178,038    | $177,565    |

See Notes to Consolidated Financial Statements
## SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended June 30, 2014 and 2013
(In thousands)

### CASH FLOWS FROM OPERATING ACTIVITIES

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in net assets prior to distributions and change in net assets attributable to District</td>
<td>$39,690</td>
<td>$36,732</td>
</tr>
<tr>
<td>Adjustments to reconcile change in net assets prior to distributions and change in net assets attributable to District to net cash provided by (used in) operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad debt expense</td>
<td>8,346</td>
<td>4,400</td>
</tr>
<tr>
<td>Amortization</td>
<td>193</td>
<td>-</td>
</tr>
<tr>
<td>Net unrealized (gains) losses on investments</td>
<td>1,451</td>
<td>(8,029)</td>
</tr>
<tr>
<td>Net realized gains on investments</td>
<td>(13,905)</td>
<td>(6,326)</td>
</tr>
<tr>
<td>Changes in operating assets and liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decrease (increase) in:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance receivables</td>
<td>6,783</td>
<td>(4,325)</td>
</tr>
<tr>
<td>Reconciliation receivables</td>
<td>(3,289)</td>
<td>(5,052)</td>
</tr>
<tr>
<td>Capitation and supplement receivables</td>
<td>(61,901)</td>
<td>76</td>
</tr>
<tr>
<td>Pharmacy rebate receivable</td>
<td>(1,959)</td>
<td>(6)</td>
</tr>
<tr>
<td>Third-party liability receivable</td>
<td>815</td>
<td>557</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>238</td>
<td>17</td>
</tr>
<tr>
<td>Provider advances</td>
<td>3,391</td>
<td>4,559</td>
</tr>
<tr>
<td>Other receivables</td>
<td>(744)</td>
<td>(759)</td>
</tr>
<tr>
<td>Due from Aetna</td>
<td>-</td>
<td>2,976</td>
</tr>
<tr>
<td>Risk share settlement</td>
<td>137</td>
<td>(3,718)</td>
</tr>
<tr>
<td>Prepaid assets</td>
<td>(1,418)</td>
<td>246</td>
</tr>
<tr>
<td>Increase (decrease) in:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical claims payable</td>
<td>43,231</td>
<td>9,574</td>
</tr>
<tr>
<td>Reconciliation payable</td>
<td>(9,940)</td>
<td>(14,595)</td>
</tr>
<tr>
<td>Deferred capitation revenue</td>
<td>-</td>
<td>(25,360)</td>
</tr>
<tr>
<td>Payable to providers</td>
<td>2,966</td>
<td>-</td>
</tr>
<tr>
<td>Due to ADHS/DBHS</td>
<td>707</td>
<td>-</td>
</tr>
<tr>
<td>Due to Aetna</td>
<td>1,602</td>
<td>1,106</td>
</tr>
<tr>
<td>Due to District</td>
<td>(83)</td>
<td>-</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>(2,342)</td>
<td>218</td>
</tr>
<tr>
<td>Net cash provided by (used in) operating activities</td>
<td>$13,969</td>
<td>(7,709)</td>
</tr>
</tbody>
</table>

### CASH FLOWS FROM INVESTING ACTIVITIES

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from sale of restricted securities</td>
<td>500</td>
<td>-</td>
</tr>
<tr>
<td>Purchase of restricted securities</td>
<td>(520)</td>
<td>(500)</td>
</tr>
<tr>
<td>Capitalized software costs</td>
<td>(3,084)</td>
<td>(762)</td>
</tr>
<tr>
<td>Purchases of investments</td>
<td>(86,866)</td>
<td>(116,835)</td>
</tr>
<tr>
<td>Proceeds from sale of investments</td>
<td>149,059</td>
<td>157,970</td>
</tr>
<tr>
<td>Net cash provided by investing activities</td>
<td>$59,089</td>
<td>39,873</td>
</tr>
</tbody>
</table>

### CASH FLOWS FROM FINANCING ACTIVITIES

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from District for Mercy Maricopa</td>
<td>-</td>
<td>5,000</td>
</tr>
<tr>
<td>Proceeds from Aetna for Mercy Maricopa start up costs</td>
<td>14,226</td>
<td>2,426</td>
</tr>
<tr>
<td>Payments to Aetna for Mercy Maricopa start up costs</td>
<td>(11,889)</td>
<td>(466)</td>
</tr>
<tr>
<td>Distributions to sponsor organizations</td>
<td>(40,000)</td>
<td>(40,000)</td>
</tr>
<tr>
<td>Net cash used in financing activities</td>
<td>(37,663)</td>
<td>(33,040)</td>
</tr>
</tbody>
</table>

### NET CHANGE IN CASH AND CASH EQUIVALENTS

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net change in cash and cash equivalents</td>
<td>$35,395</td>
<td>(876)</td>
</tr>
</tbody>
</table>

### CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents, beginning of year</td>
<td>$108,172</td>
<td>109,048</td>
</tr>
</tbody>
</table>

### CASH AND CASH EQUIVALENTS, END OF YEAR

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents, end of year</td>
<td>$143,567</td>
<td>$108,172</td>
</tr>
</tbody>
</table>

### SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuance of promissory note receivable due from District and related payable due to District (Note 6)</td>
<td>$5,000</td>
<td>-</td>
</tr>
</tbody>
</table>
1. **Company operations and significant accounting policies**

**Company operations** - Southwest Catholic Health Network Corporation dba Mercy Care Plan (SCHN, or the Plan) is a nonprofit corporation, whose sponsor organizations are Dignity Health (Dignity) and Carondelet Health Network (Carondelet), collectively the “sponsors.” SCHN provides medical care under various contracts with the Arizona Health Care Cost Containment System (AHCCCS), a department of the state of Arizona charged with administering health care for the state’s indigent population. SCHN provides medical coverage under the AHCCCS contract for the following populations:

- **AHCCCS Acute** - Members eligible under Title XIX Medicaid program and Title XXI program requirements
- **Arizona Long Term Care System (ALTCS)** - Provide institutional care, home and community based services and behavioral health services to the long term care members
- **AHCCCS Healthcare Group (HCG)** - Provide coverage primarily to small businesses. Program was terminated December 31, 2013.

SCHN also provides medical care to qualified members through a contract with the Arizona Department of Economic Security, Division of Developmental Disabilities (DES/DDD).

Effective January 22, 2013, Mercy Maricopa Integrated Care (Mercy Maricopa), 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) contracts. The initial members of Mercy Maricopa are SCHN, its two sponsor organizations Dignity and 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 of Mercy Maricopa and the formula for distributions to members effective September 9, 2013 is as follows:

<table>
<thead>
<tr>
<th>SCHN</th>
<th>85%</th>
</tr>
</thead>
<tbody>
<tr>
<td>District</td>
<td>15%</td>
</tr>
</tbody>
</table>

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

Mercy Maricopa 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 $5 million capital contribution from District. SCHN contributed additional capital totaling $25 million during the year ended June 30, 2014. For financial reporting purposes, Mercy Maricopa is consolidated with SCHN due to control through means of the membership agreement.

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 has 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. The Mercy Maricopa contract expires September 30, 2016 and has two optional one year extensions.
SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended June 30, 2014 and 2013

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

SCHN and Mercy Maricopa operate Medicare Advantage Plans (Medicare Advantage) with the Centers for Medicare and Medicaid Services (CMS), offering medical and prescription drug benefits to qualified members. Medicare Advantage operates as a special needs plan under CMS guidelines. The populations covered under Medicare Advantage are members who are eligible for both Medicare and Medicaid coverage.

SCHN has had a management agreement with Aetna since 2007, which is a continuation of the agreement held with Schaller Anderson, L.L.C. since 2001. The current agreement is operating with monthly amendments as a new contract is being developed. Mercy Maricopa has entered into a five year management agreement with Aetna effective May 1, 2013. The Mercy Maricopa agreement automatically renews for a second 5 year term and thereafter for successive one-year periods. Under the terms of the agreements, SCHN and Mercy Maricopa pay 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 organizations. SCHN and Mercy Maricopa incurred management fees per the management agreements of approximately $123,460,000 and $19,928,000 for the year ended June 30, 2014, respectively and $119,274,000 and $0 for the year ended June 30, 2013, respectively. These amounts are included in general and administrative expenses in the accompanying consolidated statements of activities and changes in net assets. At June 30, 2014 and 2013, unpaid management fees due to Aetna totaled approximately $936,000 and $0 from SCHN, respectively, and $319,000 and $0 from Mercy Maricopa, respectively and are included in Due to Aetna in the accompanying consolidated statements of financial position.

Concurrent with the management agreement, Mercy Maricopa executed a letter of agreement that remains in effect until the one year anniversary of the start date of the ADHS contract (April 1, 2014). Under the terms of the letter of agreement, Aetna will assume the costs incurred by Mercy Maricopa in pursuit of any protest filed in connection with the ADHS contract and any defense thereof. In addition, Aetna will pay for certain implementation costs, as defined in the letter of agreement, to cover employee salary and benefit costs and general and administrative expense incurred as start-up expenses. Upon termination of the letter of agreement, Mercy Maricopa shall reimburse Aetna an amount equal to the lesser of the implementation costs incurred or $20,000,000. Aetna will not incur implementation costs in excess of $4,000,000 increments without the prior written consent of Mercy Maricopa. For the years ended June 30, 2014 and 2013, Aetna paid approximately $14,226,000 and $2,426,000, respectively of Mercy Maricopa’s implementation costs. Total amounts repaid to Aetna related to implementation costs were approximately $11,889,000 and $466,000 for the years ended June 30, 2014 and 2013, respectively. Amounts due to Aetna for implementation costs totaled $4,297,000 and $1,960,000 at June 30, 2014 and 2013, respectively and are included in Due to Aetna in the accompanying consolidated statements of financial position.

SCHN’s management agreement provides for a share of risk of the results of operations. Subject to certain performance measures, amounts will either be due from or due to Aetna. Additionally, the management agreement provides for supplemental compensation to be paid to Aetna upon meeting certain performance measures. At June 30, 2014 and 2013, net amounts due to Aetna were approximately $2,000,000 and $1,106,000, respectively, relating to these provisions in the management agreement. Mercy Maricopa’s agreement does not provide for a share of the risk of the results from operations.

The significant accounting policies followed by SCHN and Mercy Maricopa, collectively referred to in these consolidated financial statements as the “Company”, are summarized below:

Consolidation policy - The consolidated financial statements include the accounts of SCHN and Mercy Maricopa. The Company reports noncontrolling interests in consolidated entities as a component of the Due to District, separate from the Company’s net assets. For purposes of consolidation, all significant inter-company balances and transactions have been eliminated.
(1) **Company operations and significant accounting policies (continued)**

**Basis of presentation** - The accompanying consolidated 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 Company's consolidated 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 Company is required to report information regarding its consolidated 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, 2014 and 2013, there were no temporarily restricted or permanently restricted net assets.

**Management’s use of estimates** - The preparation of the consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and cash equivalents** - Cash includes cash deposits in banks and cash equivalents. The Company 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).

**Capitation premiums** - The Plan receives from AHCCCS, DES/DDD and CMS fixed capitation payments, generally in advance, based on certain rates for each member enrolled with the Plan. The Plan is required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the Plan retains the funds as profit; if the costs are higher than the amount of capitation payments, the Plan absorbs the loss. Capitation premiums are recognized in the month that enrollees are entitled to health care services. Certain provisions of the AHCCCS Acute, HCG, DDD and ALTCS contracts include a risk band whereby SCHN and the AHCCCS programs share in the profits and losses of the contract, as defined in the respective contracts (reconciliation revenue). SCHN has recorded an estimate of the reconciliation revenue, within capitation premiums, based on the operational performance of the AHCCCS Acute, HCG, DDD and ALTCS lines of business. The Plan may recover certain losses for those cases eligible for reinsurance payments.

Capitation is paid prospectively as well as for prior period coverage (PPC) under the AHCCCS Acute and ALTCS contracts. The PPC period is the period of time prior to the member’s enrollment, during which a member is eligible for covered services. The timeframe is from the effective date of eligibility to the day a member is enrolled with a Contractor. The risk under PPC is shared by both the Plan and AHCCCS for the contract years ended September 30, 2014 and 2013. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the contract year.
(1) **Company operations and significant accounting policies (continued)**

The Plan shares risk with AHCCCS and DES/DDD for specific populations as follows:

- Acute Prospective
- Title XIX Waiver Group Prospective (reconciliation combined with Acute Prospective effective October 1, 2013)
- Acute Prior Period Coverage
- Newly Eligible Adults Prospective and Prior Period Coverage (effective January 1, 2014)
- ALTCS Prior Period Coverage
- DDD (reconciliation termed September 30, 2011)
- Health Care Group Risk Based Performance (program termed December 31, 2013)
- Home and Community Based Services
- Share of Cost

Profits in excess of the percentages set forth by the contract will be recouped by AHCCCS. Losses in excess of the percentages set forth by the contract will be paid to the contractor. As of June 30, 2014, the Company has recorded an estimated receivable of approximately $19,780,000 due from AHCCCS and an estimated payable of approximately $7,170,000 due to AHCCCS which is included in reconciliation receivables and reconciliation payable, respectively. Additionally, as of June 30, 2013, the Company has recorded an estimated receivable of approximately $16,491,000 due from AHCCCS and an estimated payable of approximately $17,110,000 due to AHCCCS which is included in reconciliation receivables and reconciliation payable, respectively. Reconciliation receivable and payable amounts pertaining to separate contracting agencies cannot be offset against reconciliation receivable and payable balances of a different contracting agency, and as such, amounts have been presented separately as a payable and receivable balance on the accompanying consolidated statements of financial position.

The Patient Protection and Affordable Care Act (ACA) requires that Contractors pay qualified primary care providers (and other providers specified in ACA) fees that are no less than the Medicare fee schedule in effect for 2013 and 2014, or the fee schedule rate that would result from applying the 2009 Medicare conversion factor, whichever is greater, for certain services designated by specific Current Procedural Terminology (CPT) codes. AHCCCS has developed an enhanced fee schedule containing the qualifying codes using the 2009 Medicare conversion factor in compliance with the greater-of requirement. The enhanced payments apply only to services provided on and after January 1, 2013 by qualified providers, who self-attest to AHCCCS as defined in the federal regulations.

The Plan was required to reprocess all qualifying claims for qualifying providers back to January 1, 2013 dates of service with no requirements that providers re-submit claims or initiate any action. In the event that a provider retroactively loses his/her qualification for enhanced payments, the Contractor is required to identify impacted claims and automatically reprocess for the recoupment of enhanced payments. This reprocessing will be conducted by the Contractor without requirement of further action by the provider.

AHCCCS will make quarterly cost-settlement payments to the Contractor based upon adjudicated/approved encounter data. The Contractor will be required to refund payments to AHCCCS for any reduced claim payments in the event that a provider is subsequently “decertified” for enhanced payments due to audit or other reasons. For the years ended June 30, 2014 and 2013, approximately $29,813,000 and $0 was earned from AHCCCS for these cost-settlement payments based upon adjudicated/approved encounter data, which is included in capitation premiums on the accompanying consolidated statements of activities and changes in net assets. As of June 30, 2014, no payments have been received on these amounts and accordingly these balances are included in capitation and supplement receivables on the accompanying consolidated statements of financial position.
(1) **Company operations and significant accounting policies (continued)**

For fiscal year 2014, capitation and supplement receivables also includes quality distributions to be received from AHCCCS, funded by deducting 1% from certain capitation premiums. The quality withhold will be paid to the Plan according to the Plan’s performance on selected performance measures relative to minimum performance standards. Management believes the Plan has met these standards and approximately $5,783,000 was earned from AHCCCS for these distributions for the year ended June 30, 2014, which is included in capitation premiums in the accompanying consolidated statement of activities and changes in net assets. As of June 30, 2014, no payments have been received on these amounts and the full balance is included in receivables.

Capitation and supplement and reconciliation receivables are stated at the amount management expects to collect. 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 capitation and supplement and reconciliation receivables. Capitation and supplement and reconciliation receivables at June 30, 2014 and 2013 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

Mercy Maricopa receives substantially all of its revenue from its contracts with ADHS and CMS. 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, Mercy Maricopa 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 ADHS and CMS were approximately $226,477,000 and $0 the years ended June 30, 2014 and 2013, respectively. The ADHS 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 approximately $33,132,000 and $0 for the years ended June 30, 2014 and 2013, respectively.

Mercy Maricopa contract revenue is limited by the terms of the ADHS contract to a maximum profit percentage of four percent. ADHS contract revenue that cannot be recognized due to the profit limits of approximately $707,000 for the period of April 1, 2014 through June 30, 2014 is included in due to ADHS Division of Behavioral Health Services (DBHS) on the accompanying consolidated statement of financial position and represents a reduction to operating revenue.

**Delivery supplement** - As part of the AHCCCS Acute Care contract, AHCCCS supplements capitation premiums with lump-sum payments for births by women eligible under the Medicaid program. This delivery supplement represents childbirth delivery reimbursement which is recorded when the delivery occurs. Delivery revenue of approximately $60,073,000 and $60,227,000 was recognized for the years ended June 30, 2014 and 2013, respectively. As of June 30, 2014 and 2013, approximately $158,000 and $125,000 was due from AHCCCS related to delivery supplement, respectively.

**Premium deficiency reserve** - The Company evaluates possible losses on its contracts through the end of each contract year. If necessary, a premium deficiency reserve is recorded within medical claims payable on the consolidated statements of financial position. As of June 30, 2014 and 2013, no premium deficiency reserve was considered necessary.
(1) **Company operations and significant accounting policies (continued)**

**Premium taxes** - SCHN is subject to a 2% tax on all payments received from AHCCCS for premiums, reinsurance, and reconciliations.

**Reinsurance revenue** - AHCCCS and DES/DDD provide a stop-loss reinsurance program for the Plan for partial reimbursement of reinsurable covered medical services incurred for members. The program includes a deductible, which varies based on the Plan’s enrollment and the eligibility category of the members. AHCCCS and DES/DDD reimburse the Plan based on a coinsurance amount for reinsurable covered services incurred above the deductible. SCHN and Mercy Maricopa contract with commercial reinsurers to provide reinsurance for the Medicare Advantage Plans. Reinsurance revenue is stated at the actual and estimated amounts due to SCHN and Mercy Maricopa pursuant to the AHCCCS Acute, DES/DDD, HCG, ALTCS and Medicare Advantage Plan contracts.

Below are the reinsurance thresholds by line of business:

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>Annual Deductible Effective October 1, 2013</th>
<th>Annual Deductible Effective October 1, 2012</th>
<th>Coinsurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>AHCCCS Acute – Prospective Only</td>
<td>$25,000</td>
<td>$20,000</td>
<td>75%</td>
</tr>
<tr>
<td>Title XIX Waiver Group – Prospective Only</td>
<td>25,000</td>
<td>20,000</td>
<td>75%</td>
</tr>
<tr>
<td>DES/DDD</td>
<td>20,000</td>
<td>20,000</td>
<td>75%</td>
</tr>
<tr>
<td>ALTCS w/Medicare</td>
<td>20,000</td>
<td>20,000</td>
<td>75%</td>
</tr>
<tr>
<td>ALTCS w/o Medicare</td>
<td>30,000</td>
<td>30,000</td>
<td>75%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>Annual Deductible Effective July 1, 2013</th>
<th>Annual Deductible Effective July 1, 2012</th>
<th>Coinsurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>HCG – Effective July 1, 2013 and 2012 (Termed 12/31/13)</td>
<td>$175,000</td>
<td>$225,000</td>
<td>90%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>Annual Deductible Effective January 1, 2013</th>
<th>Annual Deductible Effective January 1, 2012</th>
<th>Coinsurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCHN Medicare Advantage – effective January 1, 2014 and 2013</td>
<td>$750,000</td>
<td>$750,000</td>
<td>90%</td>
</tr>
</tbody>
</table>
(1) **Company operations and significant accounting policies (continued)**

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>Annual Deductible Effective</th>
<th>Coinsurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mercy Maricopa Medicare Advantage – effective</td>
<td>April 1, 2014 through September 30, 2015</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

To be eligible for reinsurance billing, qualified healthcare expenses must be incurred during the contract year. Reinsurance revenue is recorded based on actual billed reinsurance claims adjusted for medical cost completion factors and SCHR’s historical collection experience. Reinsurance revenue is subject to review by AHCCCS, DES/DDD, and the Medicare Advantage Plan’s commercial reinsurer, and as a result, there is at least a reasonable possibility that recorded reinsurance revenue will change by a material amount in the near future.

Reinsurance receivables represent the expected payment from AHCCCS, DES/DDD, and the Medicare Advantage Plan’s commercial insurer to the Company for certain enrollees whose qualifying medical expenses paid by the Plan were in excess of specified deductible limits. Reinsurance receivables are stated at the amount management expects to collect. 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 reinsurance receivable. At June 30, 2014 and 2013, gross reinsurance receivable totaled approximately $22,030,000 and $37,039,000, respectively. SCHR also had an allowance for doubtful accounts of approximately $4,692,000 and $3,731,000 at June 30, 2014 and 2013, respectively.

**Pharmacy rebate receivable** - SCHR receives rebates from pharmaceutical companies based on the volume of drugs purchased. SCHR records a receivable and a reduction of health care expenses for estimated rebates due based on purchase information. During the years ended June 30, 2014 and 2013, health care expenses were reduced by approximately $11,870,000 and $7,768,000 for rebates, respectively. At June 30, 2014 and 2013, management believes the pharmacy receivables are fully collectible and accordingly, an allowance has not been established.

**Third-party liability receivable** - In cases such as motor vehicle accidents and worker’s compensation claims, a third-party insurer may be liable for a claim. When SCHR pays claims on behalf of its members and determines a third-party insurance company is ultimately responsible for that claim, it estimates a receivable and recoups the claim cost from the third-party insurer. SCHR has hired an asset recovery company to manage the third-party receivable collections. Third-party liability receivables are stated at the amount management expects to collect. 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 third-party liability receivable. At June 30, 2014 and 2013, gross third-party liability receivable totaled approximately $5,586,000 and $7,160,000, respectively. SCHR also had an allowance for doubtful accounts of approximately $958,000 and $1,717,000 at June 30, 2014 and 2013, respectively.
Company operations and significant accounting policies (continued)

Provider advances - Upon request, SCHN and Mercy Maricopa 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 allowances and a credit to provider advances receivable. At June 30, 2014 and 2013, gross provider advances receivable totaled approximately $6,213,000 and $10,272,000, respectively. SCHN also had an allowance for doubtful accounts of approximately $1,566,000 and $2,323,000 at June 30, 2014 and 2013, respectively.

Risk share settlement - The risk share settlement also 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 the capitation premiums on the consolidated statements of activities and changes in net assets. The pharmacy risk share settlement for calendar year 2014 and 2013, recorded at June 30, 2014, is expected to be finalized in late 2015 and 2014, respectively. Amounts earned under this program totaled approximately $8,008,000 and $7,724,000 for the years ended June 30, 2014 and 2013, respectively, which are included as capitation premiums in the accompanying consolidated statements of activities and changes in net assets.

Health Care Group - medical loss ratio reconciliation - Effective January 1, 2011, HCG issued an amendment to its contract to include a provision for application of Plan operating profits over six percent (6%) to any outstanding reconciliation receivable balance. If the annual operating profit for SCHN exceeds six percent (6%), the amount in excess shall be applied to reduce the reconciliation receivable balance. The amount used to reduce the reconciliation receivable balance for fiscal 2014 and 2013 was approximately $0 and $2,157,000, respectively. At June 30, 2013, no reconciliation receivable balance from HCG remained as the amount was repaid in full in 2013. Effective December 31, 2013, the HCG program was terminated.

Healthcare service cost recognition - The costs of providing hospitalization, medical compensation, ancillary and other medical services, institutional, and home and community based services are accrued in the period in which the service is provided to eligible recipients based in part on estimates, including an accrual for services incurred but not yet reported to SCHN.

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 unreported services payable is developed using actuarial methods based on historical experience and are 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 consolidated 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) **Company operations and significant accounting policies (continued)**

**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 authorization 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.

**Investments** - Investments are recorded in accordance with FASB ASC 958-320, *Investments-Debt and Equity Securities* and FASB ASC 958-325, *Not-for-Profit Entities Investments – Other*. Under FASB ASC 958-320 and FASB ASC 958-325, the Company reports investments in equity securities that have readily determinable fair values, and all investments in debt securities at fair value based on quoted market prices. Investment securities without quoted market prices are valued at estimated fair value using appropriate valuation methods that consider the underlying assets. SCHN’s investment portfolio is managed by professional investment managers within guidelines established by SCHN’s Board of Directors which, as a matter of policy, limits the amounts which may be invested in any one issuer or type of investment.

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

**Restricted securities** - At June 30, 2014 and 2013, 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 for the duration of Mercy Maricopa’s contract with ADHS. Mercy Maricopa may not make withdrawals on the account without prior approval from the State of Arizona, Department of Insurance. The purchases and sales of restricted securities are recorded on a trade-date basis. Interest is recognized on the accrual basis.

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

**Investment income** - Investment income consists of interest, dividends, and realized gains and losses on investments. Interest is recognized on the accrual basis, and dividends are recorded as earned on the ex-dividend date. Interest income on mortgage- and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Accrual of income is suspended for bonds and mortgage loans that are in default or when the receipt of interest payments is in doubt. Accrual of income has not been suspended for any bonds or mortgage loans during the years ended June 30, 2014 and 2013. The Company has a policy to review and identify investments with declines in value that would be considered to be other-than-temporary. Such other-than-temporary declines, if significant, are accounted for as realized losses (See Note 3).

**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 approximately $3,845,000 and $761,000 at June 30, 2014 and 2013, respectively. Effective April 1, 2014, the software was completed and placed into service, at which time Mercy Maricopa commenced amortization. Amortization expense for the year ended June 30, 2014, and accumulated amortization as of June 30, 2014, was approximately $192,000.

**Income taxes** - SCHN 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 consolidated financial statements. Mercy Maricopa intends to apply for its tax exempt status under Section 501(c)(3) of the Code prior to February 2015. There can be no assurance that Mercy Maricopa will be granted tax exempt status. The accompanying financial statements have been prepared assuming Mercy Maricopa will be granted tax exempt status. Income determined to be unrelated business taxable income (UBTI) 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. SCHN and Mercy Maricopa evaluate their uncertain tax positions, if any, on a continual basis through review of their policies and procedures, review of their regular tax flings, and discussions with outside experts. At June 30, 2014 and 2013, SCHN and Mercy Maricopa did not have any uncertain tax positions.

SCHN’s Federal Exempt Organization Business Income Tax Returns (Form 990) for 2011, 2012, and 2013 are subject to examination by the IRS, generally for the three years after they were filed. Mercy Maricopa filed its Form 990 for 2013 and will be subject to examination by the IRS generally for three years after the return has been filed. As of the date of this report, the fiscal 2014 tax returns had not yet been filed.
(1) **Company operations and significant accounting policies (continued)**

**Performance indicator** - The consolidated statement of activities includes the performance indicator operating income. The performance indicator excludes nonoperating income (expense) and net unrealized investment gains (losses), which is consistent with industry practice.

**Recent accounting pronouncement** - In May 2014, the FASB issued ASU No. 2014-09 ("ASU 2014-09"), *Revenue from Contracts with Customers*. The core principle of ASU 2014-09 is that an entity should 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. Additionally, ASU 2014-09 will require an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. For nonpublic entities, the ASU will be effective for annual reporting periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018. Nonpublic entities may elect to early adopt the ASU, however, adoption is not permitted prior to the public entity effective date. The Company is evaluating the impact of adopting ASU 2014-09, but currently believes there will be no significant impact on their consolidated financial statements.

**Subsequent events** - The Company has evaluated subsequent events through October 23, 2014, which is the date the consolidated financial statements were available to be issued.

(2) **Reconciliation**

Reconciliation balances are recorded as a net receivable or payable on the consolidated statement of financial position by line of business. A summary of the balances by line of business for the years ended June 30 are as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Receivable</td>
<td>Payable</td>
</tr>
<tr>
<td>Acute</td>
<td>$12,450</td>
<td>$7,167</td>
</tr>
<tr>
<td>ALTCS</td>
<td>7,330</td>
<td>3</td>
</tr>
<tr>
<td>DES/DDD</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>19,780</td>
<td>7,170</td>
</tr>
<tr>
<td>Less current portion</td>
<td>(19,780)</td>
<td>(7,170)</td>
</tr>
<tr>
<td>Non-current portion</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
(3) Investments

The cost and fair value of the Company's investments by type at June 30 are as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cost</td>
<td>Fair Value</td>
</tr>
<tr>
<td>Short-term:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td>$14,065</td>
<td>$14,065</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>3,044</td>
<td>3,036</td>
</tr>
<tr>
<td></td>
<td>17,109</td>
<td>17,101</td>
</tr>
<tr>
<td>Long-term:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td>33,982</td>
<td>44,925</td>
</tr>
<tr>
<td>U.S. Government securities</td>
<td>12,265</td>
<td>12,304</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>32,155</td>
<td>33,463</td>
</tr>
<tr>
<td>Mortgage-backed securities</td>
<td>9,366</td>
<td>9,444</td>
</tr>
<tr>
<td>Preferred securities</td>
<td>4,037</td>
<td>4,432</td>
</tr>
<tr>
<td></td>
<td>91,805</td>
<td>104,568</td>
</tr>
<tr>
<td>Restricted securities</td>
<td>$108,914</td>
<td>$121,669</td>
</tr>
<tr>
<td></td>
<td>$520</td>
<td>$521</td>
</tr>
</tbody>
</table>

Investment income for the years ended June 30 is comprised of the following (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest and dividend income</td>
<td>$3,500</td>
<td>$5,051</td>
</tr>
<tr>
<td>Realized gains on investments</td>
<td>13,905</td>
<td>6,326</td>
</tr>
<tr>
<td></td>
<td>$17,405</td>
<td>$11,377</td>
</tr>
</tbody>
</table>

Management continually reviews their investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost. During the years ended June 30, 2014 and 2013, the Company recorded no losses for other-than-temporary declines in the fair value of investments.

The following table summarizes the unrealized losses on investments held at June 30, 2014 (in thousands):

<table>
<thead>
<tr>
<th>Description of securities</th>
<th>Less than twelve months</th>
<th>Twelve months or longer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fair value Unrealized losses</td>
<td>Fair value Unrealized losses</td>
<td>Fair value Unrealized losses</td>
</tr>
<tr>
<td>U.S. Government securities</td>
<td>$ - $ -</td>
<td>$ 1,092 $ 1</td>
<td>$ 1,092 $ 1</td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td>- -</td>
<td>979 45</td>
<td>979 45</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>1,570 26</td>
<td>11,161 74</td>
<td>11,161 74</td>
</tr>
<tr>
<td>Mortgage-backed securities</td>
<td>- -</td>
<td>1,647 2</td>
<td>1,647 2</td>
</tr>
<tr>
<td>Preferred securities</td>
<td>- -</td>
<td>502 5</td>
<td>502 5</td>
</tr>
<tr>
<td>Total</td>
<td>$ 1,570 $ 26</td>
<td>$ 13,811 $ 101</td>
<td>$ 15,381 $ 127</td>
</tr>
</tbody>
</table>
The following table summarizes the unrealized losses on investments held at June 30, 2013 (in thousands):

<table>
<thead>
<tr>
<th>Description of securities</th>
<th>Less than twelve months</th>
<th>Twelve months or longer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fair value</td>
<td>Unrealized losses</td>
<td>Fair value</td>
</tr>
<tr>
<td>U.S. Government securities</td>
<td>$</td>
<td>$ - $ -</td>
<td>$ 4,345</td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td>-</td>
<td>-</td>
<td>8,832</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>952</td>
<td>90</td>
<td>30,897</td>
</tr>
<tr>
<td>Mortgage-backed securities</td>
<td>-</td>
<td>-</td>
<td>14,393</td>
</tr>
<tr>
<td>Preferred securities</td>
<td>-</td>
<td>-</td>
<td>1,308</td>
</tr>
<tr>
<td>Total</td>
<td>$ 952</td>
<td>$ 90</td>
<td>$ 59,775</td>
</tr>
</tbody>
</table>

Investments classified as long-term are based on Management’s intent to hold such investments. Long-term investments can be liquidated without significant penalty within twenty-four hours, and are considered short-term for purposes of calculating current ratios under AHCCCS reporting guidelines.

The following table sets forth by level, within the fair value hierarchy, the Company’s investments at fair value as of June 30, 2014 (in thousands):

<table>
<thead>
<tr>
<th>Investments:</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$ -</td>
<td>$ 12,304</td>
<td>-</td>
<td>$ 12,304</td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td>44,925</td>
<td>-</td>
<td>-</td>
<td>44,925</td>
</tr>
<tr>
<td>U.S. large cap</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Money market mutual funds</td>
<td>11,845</td>
<td>-</td>
<td>-</td>
<td>11,845</td>
</tr>
<tr>
<td>Other</td>
<td>2,220</td>
<td>-</td>
<td>-</td>
<td>2,220</td>
</tr>
<tr>
<td>Total marketable equity securities</td>
<td>58,990</td>
<td>-</td>
<td>-</td>
<td>58,990</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>-</td>
<td>36,499</td>
<td>-</td>
<td>36,499</td>
</tr>
<tr>
<td>Mortgage-backed securities</td>
<td>-</td>
<td>9,444</td>
<td>-</td>
<td>9,444</td>
</tr>
<tr>
<td>Preferred securities</td>
<td>4,432</td>
<td>-</td>
<td>-</td>
<td>4,432</td>
</tr>
<tr>
<td>Total Investments</td>
<td>$ 63,422</td>
<td>$ 58,247</td>
<td>-</td>
<td>$ 121,669</td>
</tr>
<tr>
<td>Restricted securities</td>
<td>$ -</td>
<td>$ 521</td>
<td>-</td>
<td>$ 521</td>
</tr>
</tbody>
</table>
(4) Fair value measurements (continued)

The following table sets forth by level, within the fair value hierarchy, the Company's investments at fair value as of June 30, 2013 (in thousands):

<table>
<thead>
<tr>
<th>Investments</th>
<th>(Level 1)</th>
<th>(Level 2)</th>
<th>(Level 3)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$</td>
<td>$ 11,648</td>
<td>$</td>
<td>$ 11,648</td>
</tr>
<tr>
<td>Marketable equity securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. large cap</td>
<td>75,066</td>
<td></td>
<td></td>
<td>75,066</td>
</tr>
<tr>
<td>Money market mutual funds</td>
<td>342</td>
<td></td>
<td></td>
<td>342</td>
</tr>
<tr>
<td>Other</td>
<td>3,487</td>
<td></td>
<td></td>
<td>3,487</td>
</tr>
<tr>
<td>Total marketable equity securities</td>
<td>78,895</td>
<td></td>
<td></td>
<td>78,895</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td></td>
<td>62,553</td>
<td></td>
<td>62,553</td>
</tr>
<tr>
<td>Mortgage-backed securities</td>
<td></td>
<td>15,887</td>
<td></td>
<td>15,887</td>
</tr>
<tr>
<td>Preferred securities</td>
<td>2,426</td>
<td></td>
<td></td>
<td>2,426</td>
</tr>
<tr>
<td>Total Investments</td>
<td>$ 81,321</td>
<td>$ 90,088</td>
<td>$</td>
<td>$ 171,409</td>
</tr>
<tr>
<td>Restricted securities</td>
<td></td>
<td>$ 500</td>
<td></td>
<td>$ 500</td>
</tr>
</tbody>
</table>

The Company currently has no other financial instruments subject to fair value measurement.

For financial instruments not addressed previously and not reported at fair value, the carrying amounts approximate fair value because of the short maturities of the following: cash and cash equivalents, receivables, provider advances, risk share settlement, due from District, medical claims payable, payable to providers, reconciliation payable, due to Aetna, due to ADHS/DBHS and other current liabilities.

(5) Medical claims payable

At June 30, 2014 and 2013, claims outstanding to third parties for health care services provided to members, including estimates for incurred but not reported claims, were approximately $201 million and $157 million, respectively. The balances at June 30, 2014 and 2013 were certified by an actuary. Activity in the liability for medical claims payable and health care expense for the years ended June 30, 2014 and 2013 is as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at July 1</td>
<td>$ 157,277</td>
<td>$ 147,703</td>
</tr>
<tr>
<td>Incurred related to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current year</td>
<td>1,713,340</td>
<td>1,462,233</td>
</tr>
<tr>
<td>Prior years</td>
<td>(6,333)</td>
<td>(10,728)</td>
</tr>
<tr>
<td>Total incurred</td>
<td>1,707,007</td>
<td>1,451,505</td>
</tr>
<tr>
<td>Paid related to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current year</td>
<td>(1,510,453)</td>
<td>(1,306,929)</td>
</tr>
<tr>
<td>Prior years</td>
<td>(153,323)</td>
<td>(135,002)</td>
</tr>
<tr>
<td>Total paid</td>
<td>(1,663,776)</td>
<td>(1,441,931)</td>
</tr>
<tr>
<td>Balance at June 30</td>
<td>$ 200,508</td>
<td>$ 157,277</td>
</tr>
</tbody>
</table>
(5) Medical 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 unpaid at June 30, 2013 exceeded the actual claims incurred related to fiscal year 2013 and prior by approximately $14 million or 9%. The liability for claims unpaid at June 30, 2012 exceeded the actual claims incurred related to fiscal year 2012 and prior by approximately $11 million or 8%. The primary drivers for favorable claim development include member mix changes, active cost and encounter management, lower than anticipated member utilization, a shift from more costly inpatient and readmittance utilization to physician office visits, inpatient unit cost reductions related to state-mandated outlier reform, increased speed of claims processing, and an increased initiative to recoup provider overpayments. SCHN continues to incur claims for prior periods. The medical claims payable is adjusted each period end as more information becomes available.

Estimated third-party subrogation included as a reduction to medical and hospital expenses in the accompanying consolidated statements of activities and changes in net assets at June 30, 2014 and 2013 totaled approximately $2,850,000 and $3,485,000, respectively.

(6) Due to District

During the period from formation (January 22, 2013) through June 30, 2013, District contributed $5 million towards the initial funding of Mercy Maricopa. 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. The promissory note is due April 1, 2015, one year after the implementation of the RBHA contract for GSA 6 awarded to Mercy Maricopa. The promissory note bears no interest through the maturity date (3% subsequent to maturity if still outstanding) and is unsecured. At June 30, 2014, $5 million was outstanding under the promissory note. The promissory note is stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance for uncollectible amounts 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 allowance for uncollectible amounts. At June 30, 2014, the promissory note due from District is considered by management to be fully collectible and accordingly, an allowance for uncollectible amounts has not been provided.

In accordance with the membership agreement, any time after three years from the commencement of the ADHS RBHA contract (April 1, 2014), provided that District has paid in full the promissory note by its due date, 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, approximately $8,968,000 (the $10 million, net of District’s share of the changes in Mercy Maricopa’s net assets since formation (approximately $1,032,000)) and $4,751,000 is presented as a long-term liability, included in Due to District, within the accompanying consolidated statements of financial position at June 30, 2014 and 2013, respectively.
(7) Related party transactions

SCHN paid approximately $74,377,000 in 2014 and $81,076,000 in 2013 to Dignity and approximately $22,736,000 in 2014 and $17,694,000 in 2013 to Carondelet for hospitalization and other medical services provided to its members. Mercy Maricopa paid approximately $420,000 in 2014 and $0 in 2013 to Dignity, approximately $12,000 in 2014 and $0 in 2013 to Carondelet and approximately $2,442,000 in 2014 and $0 in 2013 to District for behavioral health and other medical services provided to its members. These balances include net prospective provider advance payments made to Dignity and Carondelet. At June 30, 2014, provider advances to Dignity and Carondelet amounted to approximately $3,047,000 and $0, respectively. At June 30, 2013, provider advances to Dignity and Carondelet amounted to approximately $3,047,000 and $7,000 respectively. During the year ended June 30, 2014 and 2013, SCHN made net asset distributions each year of $20,000,000 and $20,000,000 to both Dignity and Carondelet, respectively. The distributions were approved by AHCCCS.

(8) Commitments and contingencies

Letters of credit - At June 30, 2013, SCHN had irrevocable standby letters of credit to satisfy the AHCCCS Acute, DES/DDD and ALTCS general performance bond requirements. The total amounts available at June 30, 2013 totaled $61,650,000. No draws were made on the letters of credit for the year ended June 30, 2013. On September 30, 2013, the letters of credit with JP Morgan Chase were terminated and replaced with the performance bonds described below.

To meet Medicare requirements, SCHN has entered into demand note agreements dated January 1, 2006 with Dignity and Carondelet which allows SCHN to draw, upon demand, up to a combined maximum amount of $10,000,000. There were no draws on the note agreements as of June 30, 2014 and 2013. This agreement termed at December 31, 2013 and was replaced with the performance bonds described below.

Performance Bonds - Effective October 1, 2013, SCHN obtained unsecured performance bonds to satisfy the AHCCCS Acute, ALTCS, DES/DDD performance bond requirements. Effective January 1, 2014 SCHN obtained unsecured performance bonds to satisfy the Medicare performance bond requirements. The following table sets forth the contract requirement and the Performance Bond amounts at June 30, 2014:

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>AHCCCS Requirement</th>
<th>Performance Bond Amount</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acute</td>
<td>100% of Capitation Revenue</td>
<td>$85,500,000</td>
<td>10/1/2013</td>
</tr>
<tr>
<td>ALTCS</td>
<td>80% of Capitation Revenue</td>
<td>$30,000,000</td>
<td>10/1/2013</td>
</tr>
<tr>
<td>DDD</td>
<td>80% of Capitation Revenue</td>
<td>$2,600,000</td>
<td>10/1/2013</td>
</tr>
<tr>
<td>Medicare</td>
<td>$1,050 PMPM</td>
<td>$19,100,000</td>
<td>1/1/2014</td>
</tr>
</tbody>
</table>

In accordance with the terms of its contract with ADHS, Mercy Maricopa is required to post a performance bond with ADHS 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 $65,064,173 and $0 for the years ended June 30, 2014 and 2013, respectively. In the year ended June 30, 2014, the performance bond requirement was met through the purchase of three performance bonds totaling $65,500,000.
(8) Commitments and contingencies (continued)

Litigation - Periodically, the Company 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 Company’s consolidated financial position.

On March 25, 2013, Mercy Maricopa was awarded a contract with ADHS covering the 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 has 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.

Liability insurance - The Company maintains professional and general liability insurance coverage under claims-made policies. The Company is insured for losses up to $10 million per claim and in the aggregate, with a self-insured retention of $150,000 under its professional liability policy. The Company is insured for losses up to $2 million per claim and $4 million in the aggregate under its general liability policy. Claims reported endorsement (tail) coverage is available if the policy is not renewed to cover claims incurred but not reported. The Company anticipates that renewal coverage will be available at expiration of the current policy.

Healthcare regulation - The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future 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 Company does business, restrict revenue and enrollment growth in certain products and market segments, restrict premium growth rates for certain products and market segments, increase medical, administrative and capital costs, and expose the Company to increased risk of loss or further liabilities. The Company’s consolidated operating results, financial position and cash flows could be adversely impacted by such changes.

Contract compliance - Under the terms of the AHCCCS and Medicare Advantage (MCA) contracts, SCHN is required to meet certain financial covenants for both AHCCCS and CMS products, as applicable. As of June 30, 2014 and 2013, SCHN is in compliance with the AHCCCS covenants and CMS financial covenants, as applicable.

In accordance with the ADHS Contract, Mercy Maricopa is required to maintain certain minimum financial reporting and viability measures.
(8) Commitments and contingencies (continued)

Mercy Maricopa must maintain unrestricted minimum capitalization of at least 90% of the monthly capitation and block payments received under the Contract. As of June 30, 2014, 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. Mercy Maricopa was not in compliance with the Non-Title administrative ratio, but expects to be in compliance as of the end of the State contract year, September 30, 2014.

Should Mercy Maricopa be in default of any material obligations under the Contract, ADHS 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 ADHS. For the contract year ended September 30, 2014, Mercy Maricopa has until May 31, 2015 to submit encounters to meet the minimum number of encounters stipulated in the contract. Mercy Maricopa anticipates meeting required encounter threshold for the six month contract year ended September 30, 2014. Accordingly, as of June 30, 2014, Mercy Maricopa has not recorded a liability associated with an encounter sanction.

ADHS has a right to sanction Mercy Maricopa for other matters of non-compliance of the Contract, as determined by ADHS. Mercy Maricopa received no sanctions for the year ended June 30, 2014.

(9) Concentration of credit risk

SCHN’s future contract awards are contingent upon the continuation of the AHCCCS Acute, DES/DDD, HCG, and ALTCS programs by the State of Arizona and SCHN’s ability and desire to retain its status as a contractor under these programs. The AHCCCS Acute contract is effective through September 30, 2016, with two additional one year renewal options. The ALTCS contract will expire on September 30, 2014, with two additional one year renewal options. The DES/DDD contract was renewed through September 30, 2014. The HCG contract terminated on December 31, 2013. The Medicare Advantage contract is renewed annually by CMS. Failure to renew these contracts could have a significant impact on operations.

Mercy Maricopa currently holds a contract with the ADHS to provide services through September 2016, with two additional one year renewal options. The Medicare Advantage contract is renewed annually by CMS. Failure to renew these contracts could have a significant impact on operations.
ADDITIONAL INFORMATION
INDEPENDENT AUDITORS’ REPORT ON ADDITIONAL INFORMATION

To the Board of Directors of

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN AND AFFILIATE

We have audited the consolidated financial statements of Southwest Catholic Health Network Corporation dba Mercy Care Plan and Affiliate as of and for the years ended June 30, 2014 and 2013, and our report thereon dated October 23, 2014, which contained an unmodified opinion on those consolidated financial statements, appears on pages 1 - 2. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The additional information on pages 27 through 28 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The consolidating information on pages 25 and 26 are presented for purposes of additional analysis of the 2014 consolidated financial statements rather than to present the financial position and activities of the individual entities and are not a required part of the consolidated financial statements. The information on pages 25 through 28 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 consolidated financial statements as a whole.

Phoenix, Arizona
October 23, 2014

[Signature]
## ASSETS

<table>
<thead>
<tr>
<th></th>
<th>SCHK</th>
<th>Mercy Maricopa</th>
<th>Eliminations</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$29,407</td>
<td>$114,160</td>
<td>-</td>
<td>$143,567</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>17,101</td>
<td>-</td>
<td>-</td>
<td>17,101</td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance receivables, net of allowance for doubtful accounts of $4,692 for 2014 and $4,483 for 2013</td>
<td>17,338</td>
<td>-</td>
<td>-</td>
<td>17,338</td>
</tr>
<tr>
<td>Reconciliation receivables</td>
<td>19,780</td>
<td>-</td>
<td>-</td>
<td>19,780</td>
</tr>
<tr>
<td>Capitation and supplement receivables</td>
<td>69,668</td>
<td>-</td>
<td>-</td>
<td>69,668</td>
</tr>
<tr>
<td>Pharmacy rebate receivable</td>
<td>6,624</td>
<td>-</td>
<td>-</td>
<td>6,624</td>
</tr>
<tr>
<td>Third-party liability receivable, net of allowance for doubtful accounts of $958 for 2014 and $1,717 for 2013</td>
<td>4,628</td>
<td>-</td>
<td>-</td>
<td>4,628</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>655</td>
<td>-</td>
<td>-</td>
<td>655</td>
</tr>
<tr>
<td>Provider advances, net of allowance for doubtful accounts of $1,566 for 2014 and $2,323 for 2013</td>
<td>4,598</td>
<td>49</td>
<td>-</td>
<td>4,647</td>
</tr>
<tr>
<td>Other receivables</td>
<td>321</td>
<td>1,182</td>
<td>-</td>
<td>1,503</td>
</tr>
<tr>
<td>Risk share settlement</td>
<td>7,288</td>
<td>-</td>
<td>-</td>
<td>7,288</td>
</tr>
<tr>
<td>Prepaid assets</td>
<td>665</td>
<td>5,000</td>
<td>-</td>
<td>5,000</td>
</tr>
<tr>
<td>Due from District</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT ASSETS</strong></td>
<td>178,073</td>
<td>121,276</td>
<td>-</td>
<td>299,349</td>
</tr>
<tr>
<td><strong>RESTRICTED SECURITIES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>521</td>
<td>-</td>
<td>521</td>
</tr>
<tr>
<td><strong>CAPITALIZED SOFTWARE COSTS, net</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>3,653</td>
<td>-</td>
<td>3,653</td>
</tr>
<tr>
<td><strong>RISK SHARE SETTLEMENT, less current portion</strong></td>
<td>4,061</td>
<td>-</td>
<td>-</td>
<td>4,061</td>
</tr>
<tr>
<td><strong>INVESTMENT IN MMIC, less current portion</strong></td>
<td>49,154</td>
<td>-</td>
<td>(49,154)</td>
<td>-</td>
</tr>
<tr>
<td><strong>LONG-TERM INVESTMENTS</strong></td>
<td>104,568</td>
<td>-</td>
<td>-</td>
<td>104,568</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$335,856</td>
<td>$125,450</td>
<td>$(49,154)</td>
<td>$412,152</td>
</tr>
</tbody>
</table>

## LIABILITIES AND NET ASSETS

|                        |            |                |              |              |
| **CURRENT LIABILITIES** |            |                |              |              |
| Medical claims payable  | $141,669  | $58,839        | -            | $200,508     |
| Payable to providers    | -          | 2,966          | -            | 2,966        |
| Reconciliation payable  | 7,170      | -              | -            | 7,170        |
| Due to ADHS/DBHS        | -          | 707            | -            | 707          |
| Due to Aetna            | 2,389      | 4,616          | -            | 7,005        |
| Other current liabilities | 6,590   | 283            | -            | 6,873        |
| **TOTAL CURRENT LIABILITIES** | 157,818   | 67,411         | -            | 225,229      |
| **DUE TO DISTRICT**     | -          | 8,885          | -            | 8,885        |
| **TOTAL LIABILITIES**   | 157,818   | 76,296         | -            | 234,114      |
| **UNRESTRICTED NET ASSETS** | 178,038   | 49,154         | (49,154)     | 178,038      |
| **TOTAL LIABILITIES AND NET ASSETS** | $335,856 | $125,450 | $(49,154) | $412,152 |
# CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

**Year Ended June 30, 2014**

(In thousands)

<table>
<thead>
<tr>
<th>Operating Revenues</th>
<th>SCHN</th>
<th>Maricopa</th>
<th>Eliminations</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitation premiums</td>
<td>$1,682,741</td>
<td>$258,902</td>
<td>-</td>
<td>$1,941,643</td>
</tr>
<tr>
<td>Delivery supplement</td>
<td>60,073</td>
<td>-</td>
<td>-</td>
<td>60,073</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>50,262</td>
<td>-</td>
<td>-</td>
<td>50,262</td>
</tr>
<tr>
<td>Other, primarily third party recoveries</td>
<td>2,864</td>
<td>-</td>
<td>-</td>
<td>2,864</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING REVENUES</strong></td>
<td>1,795,940</td>
<td>258,902</td>
<td>-</td>
<td>2,054,842</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Health Care Expenses</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospitalization</td>
<td>297,088</td>
<td>-</td>
<td>-</td>
<td>297,088</td>
</tr>
<tr>
<td>Medical compensation</td>
<td>296,455</td>
<td>-</td>
<td>-</td>
<td>296,455</td>
</tr>
<tr>
<td>Ancillary and other medical services</td>
<td>676,926</td>
<td>232,317</td>
<td>-</td>
<td>909,243</td>
</tr>
<tr>
<td>Institutional</td>
<td>178,003</td>
<td>-</td>
<td>-</td>
<td>178,003</td>
</tr>
<tr>
<td>Home and community based services</td>
<td>161,882</td>
<td>-</td>
<td>-</td>
<td>161,882</td>
</tr>
<tr>
<td><strong>TOTAL HEALTH CARE EXPENSES</strong></td>
<td>1,610,354</td>
<td>232,317</td>
<td>-</td>
<td>1,842,671</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General and Administrative Expenses</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>128,369</td>
<td>31,803</td>
<td>-</td>
<td>160,172</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Premium Tax Expense</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27,228</td>
<td>-</td>
<td>-</td>
<td>27,228</td>
</tr>
</tbody>
</table>

| **TOTAL EXPENSES** | 1,765,951 | 264,120 | - | 2,030,071 |

<table>
<thead>
<tr>
<th>Operating Income (Loss)</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>29,989</td>
<td>(5,218)</td>
<td>-</td>
<td>24,771</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nonoperating Income (Expense)</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment income</td>
<td>17,403</td>
<td>2</td>
<td>-</td>
<td>17,405</td>
</tr>
<tr>
<td>Investment fees</td>
<td>(1,035)</td>
<td>-</td>
<td>-</td>
<td>(1,035)</td>
</tr>
<tr>
<td>Investment income (loss) from MMIC</td>
<td>(4,432)</td>
<td>-</td>
<td>-</td>
<td>(4,432)</td>
</tr>
<tr>
<td><strong>TOTAL NONOPERATING INCOME</strong></td>
<td>11,936</td>
<td>2</td>
<td>4,432</td>
<td>16,370</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in Net Assets Prior to Unrealized Gains (Losses) on Investments</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>41,925</td>
<td>(5,216)</td>
<td>4,432</td>
<td>41,114</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Unrealized Gains (Losses) on Investments</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1,452)</td>
<td>1</td>
<td>-</td>
<td>(1,451)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in Net Assets Prior to Capital Contributions, Distributions and Change in Net Assets Attributable to District</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40,473</td>
<td>(5,215)</td>
<td>4,432</td>
<td>39,690</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Member Contributions</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-</td>
<td>25,000</td>
<td>(25,000)</td>
<td>-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distributions to Sponsor Organizations</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(40,000)</td>
<td>-</td>
<td>-</td>
<td>(40,000)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in Net Assets Attributable to District</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-</td>
<td>783</td>
<td>-</td>
<td>783</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in Net Assets</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>473</td>
<td>20,568</td>
<td>(20,568)</td>
<td>473</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Assets, Beginning of Year</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>177,565</td>
<td>28,586</td>
<td>(28,586)</td>
<td>177,565</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Assets, End of Year</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$178,038</td>
<td>$49,154</td>
<td>$(49,154)</td>
<td>$178,038</td>
</tr>
</tbody>
</table>

*See Independent Auditors' Report on Additional Information*
## Current Assets

<table>
<thead>
<tr>
<th>Description</th>
<th>Acute</th>
<th>DES/DDD</th>
<th>HCG</th>
<th>ALTCS</th>
<th>Medicare</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>$ (11,965)</td>
<td>$ 2,056</td>
<td>$ 10,306</td>
<td>$ 19,513</td>
<td>$ 9,497</td>
<td>$ 29,407</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>8,403</td>
<td>1,075</td>
<td>-</td>
<td>6,776</td>
<td>847</td>
<td>17,101</td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance receivables, net</td>
<td>8,313</td>
<td>758</td>
<td>-</td>
<td>8,267</td>
<td>-</td>
<td>17,338</td>
</tr>
<tr>
<td>Reconciliation receivables</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>7,330</td>
<td>-</td>
<td>19,780</td>
</tr>
<tr>
<td>Capitation and supplement receivables</td>
<td>59,507</td>
<td>776</td>
<td>-</td>
<td>938</td>
<td>8,447</td>
<td>69,668</td>
</tr>
<tr>
<td>Pharmacy rebate receivable</td>
<td>2,617</td>
<td>146</td>
<td>34</td>
<td>253</td>
<td>3,574</td>
<td>6,624</td>
</tr>
<tr>
<td>Third-party liability receivable, net</td>
<td>4,021</td>
<td>20</td>
<td>85</td>
<td>502</td>
<td>-</td>
<td>4,628</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>322</td>
<td>41</td>
<td>-</td>
<td>260</td>
<td>32</td>
<td>655</td>
</tr>
<tr>
<td>Provider advances, net</td>
<td>1,755</td>
<td>143</td>
<td>223</td>
<td>1,170</td>
<td>1,307</td>
<td>4,598</td>
</tr>
<tr>
<td>Other receivables</td>
<td>321</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>321</td>
</tr>
<tr>
<td>Risk share settlement</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>7,288</td>
<td>7,288</td>
</tr>
<tr>
<td>Prepaid assets</td>
<td>392</td>
<td>4</td>
<td>-</td>
<td>49</td>
<td>220</td>
<td>665</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT ASSETS</strong></td>
<td>86,136</td>
<td>5,019</td>
<td>10,648</td>
<td>45,058</td>
<td>31,212</td>
<td>178,073</td>
</tr>
</tbody>
</table>

### Risk Share Settlement, less current portion
- 4,061

### Investment in MMIC
- 21,072

### Long-Term Investments
- 51,379

**TOTAL ASSETS**
- $158,587

## Liabilities and Net Assets

### Current Liabilities

<table>
<thead>
<tr>
<th>Description</th>
<th>Acute</th>
<th>DES/DDD</th>
<th>HCG</th>
<th>ALTCS</th>
<th>Medicare</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical claims payable</td>
<td>$ 66,224</td>
<td>$ 3,019</td>
<td>$ 21</td>
<td>$ 51,004</td>
<td>$ 21,401</td>
<td>$ 141,669</td>
</tr>
<tr>
<td>Reconciliation payable</td>
<td>7,167</td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>7,170</td>
</tr>
<tr>
<td>Due to Aetna</td>
<td>2,048</td>
<td>(114)</td>
<td>-</td>
<td>147</td>
<td>308</td>
<td>2,389</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>2,683</td>
<td>99</td>
<td>10</td>
<td>1,755</td>
<td>2,043</td>
<td>6,590</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td>78,122</td>
<td>3,004</td>
<td>31</td>
<td>52,909</td>
<td>23,752</td>
<td>157,818</td>
</tr>
</tbody>
</table>

### Unrestricted Net Assets
- 80,465

**TOTAL LIABILITIES AND NET ASSETS**
- $158,587
<table>
<thead>
<tr>
<th></th>
<th>Acute</th>
<th>DES/DDD</th>
<th>HCG</th>
<th>ALTCS</th>
<th>Medicare</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>OPERATING REVENUES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capitation premiums</td>
<td>$831,785</td>
<td>$39,031</td>
<td>$4,604</td>
<td>$458,299</td>
<td>$349,022</td>
<td>$1,682,741</td>
</tr>
<tr>
<td>Delivery supplement</td>
<td>60,073</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>60,073</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>23,671</td>
<td>1,509</td>
<td>-</td>
<td>25,082</td>
<td>-</td>
<td>50,262</td>
</tr>
<tr>
<td>Other, primarily third party recoveries</td>
<td>1,987</td>
<td>13</td>
<td>11</td>
<td>484</td>
<td>369</td>
<td>2,864</td>
</tr>
<tr>
<td>TOTAL OPERATING REVENUES</td>
<td>917,516</td>
<td>40,553</td>
<td>4,615</td>
<td>483,865</td>
<td>349,391</td>
<td>1,795,940</td>
</tr>
<tr>
<td>HEALTH CARE EXPENSES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hospitalization</td>
<td>167,315</td>
<td>5,684</td>
<td>524</td>
<td>16,997</td>
<td>106,568</td>
<td>297,088</td>
</tr>
<tr>
<td>Medical compensation</td>
<td>237,896</td>
<td>6,901</td>
<td>862</td>
<td>15,140</td>
<td>35,656</td>
<td>296,455</td>
</tr>
<tr>
<td>Ancillary and other medical services</td>
<td>410,529</td>
<td>25,903</td>
<td>1,976</td>
<td>60,379</td>
<td>178,139</td>
<td>676,926</td>
</tr>
<tr>
<td>Institutional</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>178,003</td>
<td>-</td>
<td>178,003</td>
</tr>
<tr>
<td>Home and community based services</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>161,882</td>
<td>-</td>
<td>161,882</td>
</tr>
<tr>
<td>TOTAL HEALTH CARE EXPENSES</td>
<td>815,740</td>
<td>38,488</td>
<td>3,362</td>
<td>469,875</td>
<td>351,495</td>
<td>1,765,951</td>
</tr>
<tr>
<td>GENERAL AND ADMINISTRATIVE EXPENSES</td>
<td>66,563</td>
<td>2,869</td>
<td>312</td>
<td>27,493</td>
<td>31,132</td>
<td>128,369</td>
</tr>
<tr>
<td>PREMIUM TAX EXPENSE</td>
<td>17,247</td>
<td>-</td>
<td>-</td>
<td>9,981</td>
<td>-</td>
<td>27,228</td>
</tr>
<tr>
<td>TOTAL EXPENSES</td>
<td>899,550</td>
<td>41,357</td>
<td>3,674</td>
<td>469,875</td>
<td>351,495</td>
<td>1,765,951</td>
</tr>
<tr>
<td>OPERATING INCOME (LOSS)</td>
<td>17,966</td>
<td>(804)</td>
<td>941</td>
<td>13,990</td>
<td>(2,104)</td>
<td>29,989</td>
</tr>
<tr>
<td>NONOPERATING INCOME (EXPENSE)</td>
<td>8,551</td>
<td>1,094</td>
<td>-</td>
<td>6,896</td>
<td>862</td>
<td>17,403</td>
</tr>
<tr>
<td>Investment income</td>
<td>(509)</td>
<td>(65)</td>
<td>-</td>
<td>(410)</td>
<td>(51)</td>
<td>(1,035)</td>
</tr>
<tr>
<td>Investment loss from MMIC</td>
<td>(515)</td>
<td>-</td>
<td>-</td>
<td>(3,671)</td>
<td>(246)</td>
<td>(4,432)</td>
</tr>
<tr>
<td>TOTAL NONOPERATING INCOME</td>
<td>7,527</td>
<td>1,029</td>
<td>-</td>
<td>2,815</td>
<td>565</td>
<td>11,936</td>
</tr>
<tr>
<td>CHANGE IN NET ASSETS PRIOR TO UNREALIZED GAINS (LOSSES) ON INVESTMENTS</td>
<td>25,493</td>
<td>225</td>
<td>941</td>
<td>16,805</td>
<td>(1,539)</td>
<td>41,925</td>
</tr>
<tr>
<td>UNREALIZED GAINS (LOSSES) ON INVESTMENTS</td>
<td>(772)</td>
<td>(43)</td>
<td>(85)</td>
<td>(481)</td>
<td>(71)</td>
<td>(1,452)</td>
</tr>
<tr>
<td>CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS</td>
<td>24,721</td>
<td>182</td>
<td>856</td>
<td>16,324</td>
<td>(1,610)</td>
<td>40,473</td>
</tr>
<tr>
<td>DISTRIBUTIONS TO SPONSOR ORGANIZATIONS</td>
<td>(20,000)</td>
<td>-</td>
<td>-</td>
<td>(20,000)</td>
<td>-</td>
<td>(40,000)</td>
</tr>
<tr>
<td>CHANGE IN NET ASSETS</td>
<td>4,721</td>
<td>182</td>
<td>856</td>
<td>(3,676)</td>
<td>(1,610)</td>
<td>473</td>
</tr>
<tr>
<td>NET ASSETS, BEGINNING OF YEAR</td>
<td>75,744</td>
<td>8,405</td>
<td>9,761</td>
<td>57,339</td>
<td>26,316</td>
<td>177,565</td>
</tr>
<tr>
<td>NET ASSETS END OF YEAR</td>
<td>$80,465</td>
<td>$8,587</td>
<td>$10,617</td>
<td>$53,663</td>
<td>$24,706</td>
<td>$178,038</td>
</tr>
</tbody>
</table>

See Independent Auditors' Report on Additional Information