

# **The University of Arizona Health Plans—Family Care, Inc.**

Financial Statements  
With Independent Auditor's Report Thereon  
June 30, 2015 and 2014

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## Independent Auditor's Report

To the Board of Directors  
The University of Arizona Health Plans—Family Care, Inc.  
Tucson, Arizona

### Report on the Financial Statements

We have audited the accompanying financial statements of The University of Arizona Health Plans—Family Care, Inc. (UFC), a subsidiary of Banner Health (Banner), which comprise the balance sheets as of June 30, 2015 and 2014; the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended; and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

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

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

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position The University of Arizona Health Plans—Family Care, Inc., a subsidiary of Banner Health, as of June 30, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1 to the financial statements, The University of Arizona Health Network, Inc. (UAHN) and its subsidiary, UFC, merged into Banner Health on February 28, 2015, with Banner Health as the surviving entity, all pursuant to an agreement, dated January 30, 2015, among The University of Arizona Health Network, Inc., the Arizona Board of Regents, acting for and on behalf of The University of Arizona, and Banner Health.

As discussed in Note 6 to the financial statements, the 2014 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

A handwritten signature in cursive script that reads "McGladrey LLP".

Minneapolis, Minnesota  
October 16, 2015

The University of Arizona Health Plans—Family Care, Inc.

**Balance Sheets**  
**June 30, 2015 and 2014**

<b>Assets</b>	<b>2015</b>	2014 Restated
<b>Current Assets</b>		
Cash	\$ 91,929,619	\$ -
Reinsurance receivable	7,562,535	6,931,037
Capitation and supplemental revenues receivable	174,790	312,583
Due from affiliate	-	75,531,888
Reconciliation receivable	1,790,503	449,271
Other current assets	1,522,065	711,395
<b>Total current assets</b>	<b>102,979,512</b>	83,936,174
Reconciliation Receivable	825,658	5,270,261
Other Assets	361,232	223,094
<b>Total</b>	<b>\$ 104,166,402</b>	<b>\$ 89,429,529</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 1,387,728	\$ 3,741,499
Due to affiliate	11,323,776	-
Medical claims payable	41,270,000	44,302,576
Reconciliation payable	6,742,257	2,110,228
Payment reform/shared savings payable	3,082,631	-
Other current liabilities	394,381	4,880,226
<b>Total current liabilities</b>	<b>64,200,773</b>	55,034,529
Reconciliation Payable	2,875,611	132,202
<b>Total liabilities</b>	<b>67,076,384</b>	55,166,731
<b>Commitments and Contingencies</b>		
Unrestricted Net Assets	37,090,018	34,262,798
<b>Total</b>	<b>\$ 104,166,402</b>	<b>\$ 89,429,529</b>

See Notes to Financial Statements.

The University of Arizona Health Plans—Family Care, Inc.

Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended June 30, 2015 and 2014

	2015	2014 Restated
Revenues, net:		
Capitation	\$ 370,299,528	\$ 289,123,926
PPC capitation	36,287,115	13,341,705
Delivery supplement	19,113,914	18,543,731
Adults <= 106 reconciliation settlement	25,916	(4,714)
PPC reconciliation settlement	(10,500,759)	(1,459,325)
Prospective Tiered reconciliation settlement	(1,875,831)	1,875,831
Adults > 106 reconciliation settlement	2,038,784	(874,308)
PCP Parity cost settlement	2,777,625	5,270,261
<b>Total revenues, net</b>	<b>418,166,292</b>	<b>325,817,107</b>
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	67,165,936	54,015,863
PPC—hospital inpatient	8,114,242	9,854,731
<b>Total hospitalization expenses</b>	<b>75,280,178</b>	<b>63,870,594</b>
Medical compensation:		
Primary care physician services	19,916,675	16,327,280
Referral physician services	49,772,041	36,424,753
Other professional services	17,677,781	11,659,550
PPC—physician services	2,088,744	2,003,070
PCP Parity enhanced payment	2,777,625	5,270,261
<b>Total medical compensation expenses</b>	<b>92,232,866</b>	<b>71,684,914</b>
Other medical expenses:		
Emergency facility services	41,317,797	31,160,414
Pharmacy	77,584,831	50,877,146
Lab, X-ray and medical imaging	17,883,122	13,347,452
Outpatient facility	46,683,803	33,041,290
Durable medical equipment	3,620,313	2,395,436
Dental	13,104,320	11,357,782
Transportation	22,161,134	14,311,042
Nursing facility, home health care	5,607,139	4,070,890
Physical therapy	1,234	3,654
Shared savings arrangements	1,156,479	-
PPC—other	4,047,076	5,102,205
<b>Total other medical expenses</b>	<b>233,167,248</b>	<b>165,667,311</b>
<b>Total health care expenses</b>	<b>400,680,292</b>	<b>301,222,819</b>
Less:		
Reinsurance recoveries	18,256,784	11,893,997
Third-party liability, net of collection fees	1,826,137	1,125,235
<b>Total net health care expenses</b>	<b>380,597,371</b>	<b>288,203,587</b>

(Continued)

The University of Arizona Health Plans—Family Care, Inc.

Statements of Revenues, Expenses and Changes in Net Assets (Continued)  
 Years Ended June 30, 2015 and 2014

	2015	2014 Restated
Administrative expenses:		
Compensation	15,249,307	13,060,442
Data processing	2,370,376	2,107,229
Management fees	1,925,982	2,366,407
Interest	159,103	17,284
Occupancy	67,692	133,043
Depreciation	937,354	750,316
Marketing	77,229	68,511
Other	5,240,457	6,072,646
<b>Total administrative expenses</b>	<b>26,027,500</b>	<b>24,575,878</b>
Premium taxes	8,714,201	6,737,108
<b>Total operating expenses</b>	<b>415,339,072</b>	<b>319,516,573</b>
<b>Operating gain</b>	<b>2,827,220</b>	<b>6,300,534</b>
Net assets, beginning	34,262,798	27,962,264
Net assets, ending	<b>\$ 37,090,018</b>	<b>\$ 34,262,798</b>

See Notes to Financial Statements.

The University of Arizona Health Plans—Family Care, Inc.

Statements of Cash Flows  
Years Ended June 30, 2015 and 2014

	2015	2014 Restated
<b>Cash Flows From Operating Activities</b>		
Cash received for services provided and other operating activities	\$ 447,285,509	\$ 334,812,836
Cash paid to providers and facilities	(403,712,868)	(277,494,670)
Cash paid for supplies, purchased services and other	(38,498,686)	(24,160,712)
<b>Net cash provided by operating activities</b>	<b>5,073,955</b>	<b>33,157,454</b>
<b>Cash Flows From Investing Activities</b>		
Change in due from (to) affiliate	86,855,664	(33,157,454)
<b>Net change in cash</b>	<b>91,929,619</b>	-
Cash, beginning	-	-
Cash, ending	<b>\$ 91,929,619</b>	<b>\$ -</b>
<b>Reconciliation of Operating Gain to Net Cash Provided by Operating Activities</b>		
Operating gain	\$ 2,827,220	\$ 6,300,534
Adjustments to reconcile operating gain to net cash provided by operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	(631,498)	1,327,351
Capitation and supplemental revenues receivable	137,793	(173,886)
Other current assets	(810,670)	164,782
Reconciliation receivable	3,103,371	(4,826,716)
Other assets	(138,138)	39,370
Accounts payable	(2,353,771)	2,982,221
Medical claims payable	(3,032,576)	23,728,149
Reconciliation payable	7,375,438	(515,035)
Payment reform/shared savings payable	3,082,631	-
Other current liabilities	(4,485,845)	4,130,684
<b>Net cash provided by operating activities</b>	<b>\$ 5,073,955</b>	<b>\$ 33,157,454</b>

See Notes to Financial Statements.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 1. Organization and Operations

**Organizational structure:** In June 2010, The University of Arizona Health Network (UAHN) was created to bring University Medical Center (UMC) and University Physicians Healthcare (UPH) together to align the two organizations strategically and operationally. After the creation of UAHN, UMC's and UPH's bylaws were changed, designating UAHN as UMC's and UPH's sole member and granting UAHN certain reserved power and authority.

The University of Arizona Health Plans—Family Care, Inc. (UFC or the Plan) provides health plan services to enrollees under a contract with the Arizona Health Care Cost Containment System (AHCCCS) in various counties in southern Arizona. University Physicians Health Plans—University Family Care, LLC (UPHP-UFC) was originally formed to operate the contract with AHCCCS, and during September 2013 UPHP-UFC was merged with and into UFC. Through this merger, UPHP-UFC ceased its separate existence and UFC, as the surviving entity, succeeded UPHP-UFC in all rights, obligations and purposes. UFC was created solely for the purpose of the merger and did not have operations prior to the merger.

On February 28, 2015, UAHN, Banner Health (Banner), and the University of Arizona (UA) entered into a strategic affiliation through the merger of UAHN and its wholly owned subsidiaries into Banner, and the execution by Banner and UA of a 30-year academic affiliation agreement providing for ongoing support of the UA Colleges of Medicine in Tucson and Phoenix. Banner Health has replaced UPH as sole corporate member of UFC.

Prior to February 2015, UFC was a component unit of UAHN under the Governmental Accounting Standards Board financial reporting model. After reassessing its articles of incorporation and bylaws due to the acquisition, UFC determined that it no longer meets the definition of a governmental entity and thus adopted Financial Accounting Standards Board (FASB) financial reporting. Prior to its acquisition by Banner Health, UFC utilized Governmental Accounting Standards Board (GASB) financial reporting. The financial statement items affected by the change in financial reporting were changes to disclosures in the areas of cash and terminology used to describe net assets. There were no material impacts to the accounting treatment or related effects on net income or net assets. As such, it is management's determination that presentation of comparative financial statements is appropriate.

All of the Plan's revenues were earned under its AHCCCS contract. This contract is subject to renewal. In March 2013, UFC was awarded a new five-year contract with AHCCCS to operate UFC through September 30, 2018. Continuation of the AHCCCS programs is dependent upon governmental policies. The loss of this contract would have an adverse effect on UFC's future operations.

#### Note 2. Summary of Significant Accounting Policies

**Basis of accounting:** UFC is a health care organization, as defined in the American Institute of Certified Public Accountants' (AICPA) *Audit and Accounting Guide, Health Care Entities*, and follows accounting principles generally accepted in the United States of America. UFC follows applicable FASB financial reporting principles and has prepared UFC's financial statements on the accrual basis of accounting.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

**Use of estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

**Cash:** During 2015, UFC began maintaining cash in a bank account that frequently exceeds federally insured limits. To date, UFC has not experienced any losses on this account.

Prior to 2015, UAHN maintained all cash generated by UFC. Therefore, there was no cash presented in the balance sheet. The balance was maintained in due from affiliate and was due on demand from UAHN. As a result, UAHN assumed any credit risk associated with the cash held on behalf of UFC.

**Other assets:** UFC is a collaborator with Cenpatco of Arizona, Inc. (COA), which was awarded the contract for the Regional Behavioral Health Authority for all of central and southern Arizona, excluding Maricopa County. UFC has purchased 10 percent of the shares of COA for approximately \$190,000, which is reflected as other assets within the accompanying balance sheets under the cost method. UFC has also guaranteed additional pro rata share purchases to allow COA to achieve a capital balance at or above 300 percent of its statutorily mandated capital. The unfunded commitment for UFC's pro rata share is estimated to be approximately \$6,200,000.

**Fair value of financial instruments:** The carrying amounts for cash, reinsurance, capitation and supplemental revenues receivables, reconciliation receivables and payables, accounts payable, due to affiliate, medical claims payable, and other current liabilities approximate fair values due to the short-term nature of these accounts.

**Reinsurance receivable:** Reinsurance receivable represents management's estimate of the medical claims cost it has earned that will be recoverable under its reinsurance contracts and is calculated based on the identification of qualifying incurred inpatient and pharmacy expenses and a percentage of estimated inpatient and other pharmaceutical costs incurred but not yet reported. As a result, there is a possibility that recorded estimates will change by a material amount in the near term. UFC recorded additional reinsurance recoveries of approximately \$876,000 during 2015 and \$347,000 in 2014, which represents an increase in amounts over the 2014 and 2013 estimates, respectively.

**Medical claims payable:** The costs of hospital and medical services provided to enrollees served under contract are recognized in the period that the services are rendered. A provision has been made for claims in process of review and for claims incurred but not received at year-end. The amount of this liability is computed using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term.

**Premium deficiency reserves:** UFC performs periodic analysis of its expected future health care costs and maintenance costs to determine whether such costs will exceed anticipated future revenues under its contracts. Should expected costs exceed anticipated revenues, a premium deficiency reserve is recognized. Investment income is not included in the calculation of premium deficiency reserves. UFC contract rates and anticipated expenses did not require a premium deficiency reserve at June 30, 2015 or 2014.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

**Capitation revenues:** Capitation revenues include premiums earned under contracts that require UFC to provide health care services to subscribers of AHCCCS for monthly capitation fees, as agreed upon by UFC and AHCCCS. Capitation revenues are recognized as revenue in the period to which health care coverage relates. Amounts receivable under these contracts are recorded as capitation and supplemental revenue receivable. Capitation rates for nonreconciled risk groups are subject to adjustment based on national episodic/diagnostic risk. As such, there is a possibility that recorded amounts will change by a material amount in the near term.

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

**Reconciliation settlements (contra-revenue):** Amounts due to (from) the State of Arizona for prior-period coverage (PPC) reconciliation settlement revenue (contra-revenue) represents UFC's profit or loss in excess of 2 percent of capitation received for the population and is estimated based upon the state's applicable policy. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) the State of Arizona for the Adults  $\leq$  106 percent of the Federal Poverty Level (Adults  $\leq$  106, formerly known as TWG) reconciliation settlement represents UFC's profit or loss for these members in excess of 2 percent for the population. For the contract years ending September 30, 2015 and 2014, UFC is no longer subject to reconciliation settlement on this population. For the contract year ended September 30, 2013, the Adults  $\leq$  106 reconciliation settlement represents UFC's profit or loss for these members in excess of 2 percent of capitation received for the nonmedical expense deduction (nonmed) population. Because the Adults  $\leq$  106 reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) the State of Arizona for the Prospective Tiered reconciliation settlement represents UFC's profit or loss for the prospective members. For the contract years ending September 30, 2015 and 2014, this tiered reconciliation settlement represents 50 percent of UFC's profit for these members in excess of 3 percent to 6 percent and 100 percent of UFC's profit over 6 percent or 100 percent of UFC's loss for these members in excess of 3 percent of capitation. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) the State of Arizona for the Adults  $>$  106 percent of the Federal Poverty Level (Adults  $>$  106, formerly known as Newly Eligible Adults) reconciliation settlement represents UFC profit or loss for these members. For the contract years ending September 30, 2015 and 2014, the Adults  $>$  106 reconciliation settlement represents UFC's profit or loss for these members in excess of 1 percent of capitation. Because the Adults  $>$  106 reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

**PCP Parity cost settlement:** Section 1202 of the Affordable Care Act requires minimum levels of payment for certain primary care services (Primary Care Provider Parity or PCP Parity) provided by certain physicians for dates of service beginning January 1, 2013, through December 31, 2014. The enhanced reimbursement requirements for UFC are subject to reimbursement by the State of Arizona. PCP Parity cost settlement revenue represents reimbursement of eligible enhanced payment expenses incurred by UFC and reimbursable by the State of Arizona.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

**Payment reform/shared savings program settlement:** AHCCCS has developed the payment reform policy with the intent to drive innovative arrangements that will further enhance cost control and result in quality improvements, while also offering providers incentive to participate in these arrangements. UFC is required to participate in these payment reform efforts as delineated by AHCCCS. For 2015, UFC has a payable to AHCCCS for approximately \$3,083,000 related to this policy.

**Administrative expenses:** Administrative expenses, including depreciation, are recognized as incurred and consist of administrative expenses that directly relate to the AHCCCS program and an allocation for general and administrative expenses. These expenses are repaid by UFC through intercompany settlements to Banner Health. These settlements are reflected as due to affiliate within the accompanying balance sheets.

**Premium tax:** The State of Arizona imposes a premium tax on capitation payments paid to UFC by AHCCCS. UFC receives the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. UFC includes the taxes collected as revenues and taxes remitted as an expense in the accompanying statements of revenues, expenses and changes in net assets.

**Income taxes:** UFC is established as a tax-exempt organization for federal income tax purposes under section 501(c)(3) of the Internal Revenue Code. UFC has also been established as a tax-exempt organization for state income tax purposes. UFC applied for tax-exempt section 501(c)(3) status with the Internal Revenue Service, and the application is pending. UFC is only subject to income taxes on unrelated business taxable income (UBTI). As a result, UFC is required to file informational returns for federal and state purposes and, if it has UBTI, federal and state income tax returns. No income taxes are reflected in the accompanying financial statements.

As described in Note 1, UPHP-UFC was merged with and into UFC during September 2013. UFC was the surviving domestic not-for-profit corporation with UPH as its sole corporate member. Pursuant to the strategic affiliation described in Note 1, Banner Health replaced UPH as the sole corporate member of UFC. Previously, UPHP-UFC was a single-member LLC that was reported within the tax returns of UPH.

UPH is only subject to income taxes on unrelated business taxable income (UBTI). As a result, UPH is required to file informational returns for federal and state purposes and, if it has UBTI, federal and state income tax returns. With limited exceptions, UPH is no longer subject to tax examination for any years ended earlier than June 30, 2011, for federal and June 30, 2010, for state. Management has performed its evaluation of tax positions taken on all open tax returns and has determined that there were no positions taken that do not meet the “more likely than not” standard.

**Risk management:** UFC is exposed to various risks of loss from torts, business interruption, errors and omissions, and natural disasters. Commercial insurance coverage is purchased by Banner for claims arising from such matters.

UFC receives reinsurance coverage from the State of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The gross capitation rates were reduced by the reinsurance cost. Under the state program, risk of loss for inpatient claims is generally limited to an annual deductible of \$25,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid at either 75 percent or 85 percent, depending on the type of claim, with no maximum annual benefit. Eligible reinsurance claims are reported in the accompanying financial statements as a reduction of health care expenses at the amount expected to be collected from AHCCCS.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

**Subsequent events:** All of the effects of subsequent events that provide additional evidence about conditions that existed at the financial statement date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. UFC does not recognize subsequent events that provide evidence about conditions that did not exist at the financial statement date but arose after, but before the financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the financial statements from being misleading.

UFC has purchased \$900,000 of additional shares of COA during September 2015, which represents UFC's pro rata share of additional capital required by COA. UFC has committed to make an additional pro rata purchase of \$5,300,000 in shares during October 2015.

UFC has evaluated events and transactions occurring subsequent to June 30, 2015, through October 16, 2015, the date of issuance of the financial statements. During this period, there were no events requiring recognition in the financial statements. Additionally, there were no nonrecognized subsequent events requiring disclosure, with the exception of the disclosure in the preceding paragraph.

**Accounting standards not yet adopted:** Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, will be effective for UFC on July 1, 2019. This ASU required revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled to in an exchange of goods or services. UFC has not yet determined the effect this ASU will have on the Plan's financial statements.

ASU No. 2015-09, *Financial Services—Insurance: Disclosures about Short-Duration Contracts*, will be effective for UFC on July 1, 2017. The main objective of this ASU is to increase the decision usefulness of the information about a reporting entity's insurance liabilities, including the nature, amount, timing and uncertainty of cash flows related to those liabilities and the effect of those cash flows on the statement of comprehensive income. UFC has not yet determined the effect this ASU will have on the Plan's financial statements.

#### Note 3. Medical Claims Payable

Medical claims payable consists of the following at June 30, 2015 and 2014:

	2015	2014
Claims payable or pending approval	\$ 20,096,045	\$ 26,176,012
Provisions for claims incurred but not yet reported	21,173,955	18,126,564
	<u>\$ 41,270,000</u>	<u>\$ 44,302,576</u>

The cost of health care services is recognized in the period in which care is provided and includes an estimate of the cost of services that has been incurred but not yet reported. UFC estimates accrued claims payable based on historical claims payments and other relevant information. Unpaid claims adjustment expenses are an estimate of the cost to process the incurred but not reported claims and are included in medical claims payable. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims paid is dependent on future developments, management is of the opinion that the accrued medical claims payable is adequate.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 3. Medical Claims Payable (Continued)

The following is a reconciliation of the accrued claims payable for the years ended June 30, 2015 and 2014:

	2015	2014
Beginning balance	\$ 44,302,576	\$ 20,574,427
Incurred:		
Current	401,106,278	301,739,239
Prior	(425,986)	(516,420)
Total	400,680,292	301,222,819
Paid:		
Current	359,836,278	257,436,663
Prior	43,876,590	20,058,007
Total	403,712,868	277,494,670
Ending balance	\$ 41,270,000	\$ 44,302,576

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

#### Note 4. Related-Party Transactions

UFC purchases physician and hospital-based health care services for its members from Banner Health and its subsidiaries. During 2015 and 2014, UFC paid claims for medical expenses to Banner Health and its subsidiaries totaling \$52,424,849 and \$42,442,627, respectively. In addition, UFC purchases administrative services from Banner Health and its subsidiaries, which are recognized as administrative expenses in the statements of revenues, expenses and changes in net assets.

At June 30, 2015, UFC had a payable totaling \$11,323,776 due to affiliates. At June 30, 2014, UFC had a receivable totaling \$75,531,888 due from affiliates.

## The University of Arizona Health Plans—Family Care, Inc.

### Notes to Financial Statements

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#### Note 5. Commitments and Contingencies

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

**AHCCCS performance measures:** UFC's contract with AHCCCS requires UFC to be in compliance with certain financial and nonfinancial performance measures, as well as certain prerequisites to maintain UFC's eligibility as a party to the contract with AHCCCS. During fiscal year 2014, for the contract year ended September 30, 2012, management determined that UFC did not meet certain AHCCCS nonfinancial performance measures. In response to these violations, AHCCCS may require UFC to submit a corrective action plan to cure the violations and may subject UFC to additional sanctions for the contract year ended September 30, 2013. At June 30, 2015 and 2014, UFC accrued estimated sanctions of \$350,000 and \$450,000, respectively, related to this potential liability. Due to the uncertainty of the outcome of AHCCCS' review, it is reasonably possible that recorded estimates will change by a material amount in the near term. Management believes that UFC is in compliance with these measures for contract periods ending after September 30, 2014. Compliance with these performance measures can be subject to future review by AHCCCS and may result in sanctions unknown or unasserted at this time.

**Performance bond:** Banner, as successor to UPH, secured an annual performance bond on behalf of UFC in the amount of \$35,000,000 with an unrelated third-party insurance company to satisfy the performance bond requirement of UFC's AHCCCS contract. The bond satisfies UFC's contractual obligation as prescribed by AHCCCS. The current performance bond expires September 30, 2016.

**Health care regulatory environment:** The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, and reimbursement for patient services. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that UFC is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

The University of Arizona Health Plans—Family Care, Inc.

Notes to Financial Statements

**Note 6. Restatement (Correction of Error)**

Following is a summary of the change to revenues, reconciliation receivables and payables (and related effects on the statement of cash flows), and net assets from amounts previously reported due to correction of an error:

	<u>2014</u>
Reconciliation receivable, change in statement of cash flows—year ended June 30, 2014, as originally reported	\$ (10,184,268)
Recognition of reconciliation error	<u>5,357,552</u>
Reconciliation receivable, change in statement of cash flows—year ended June 30, 2014, restated for correction of error	<u>\$ (4,826,716)</u>
Reconciliation payable, change in statement of cash flows—year ended June 30, 2014, as originally reported	\$ 2,525,741
Recognition of reconciliation error	<u>(3,040,776)</u>
Reconciliation payable, change in statement of cash flows—year ended June 30, 2014, restated for correction of error	<u>\$ (515,035)</u>
PPC reconciliation settlement revenue—year ended June 30, 2014, as originally reported	\$ 5,203,563
Recognition of reconciliation error	<u>(6,662,888)</u>
PPC reconciliation settlement revenue—year ended June 30, 2014, restated for correction of error	<u>\$ (1,459,325)</u>
Prospective Tiered reconciliation settlement revenue—year ended June 30, 2014, as originally reported	\$ (2,470,281)
Recognition of reconciliation error	<u>4,346,112</u>
Prospective Tiered reconciliation settlement revenue—year ended June 30, 2014, restated for correction of error	<u>\$ 1,875,831</u>
Reconciliation payable—June 30, 2014, as originally reported	\$ 3,172,978
Recognition of reconciliation error	<u>(3,040,776)</u>
Reconciliation payable—June 30, 2014, restated for correction of error	<u>\$ 132,202</u>
Reconciliation receivable—June 30, 2014, as originally reported	\$ 10,627,813
Recognition of reconciliation error	<u>(5,357,552)</u>
Reconciliation receivable—June 30, 2014, restated for correction of error	<u>\$ 5,270,261</u>
Net assets—June 30, 2014, as originally reported	\$ 36,579,574
Recognition of reconciliation error	<u>(2,316,776)</u>
Net assets—June 30, 2014, as restated for correction of error	<u>\$ 34,262,798</u>
Operating gain—year ended June 30, 2014, as originally reported	\$ 8,617,310
Recognition of reconciliation error	<u>(2,316,776)</u>
Operating gain—year ended June 30, 2014, as restated for correction of error	<u>\$ 6,300,534</u>