Financial Statements and Supplementary Information

The University of Arizona Health Plans – Family Care, Inc.
Year Ended December 31, 2016
With Independent Auditor's Report

Ernst & Young LLP

Building a better
working world

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

Financial Statements and Supplementary Information

Year Ended December 31, 2016

Contents

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

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

Independent Auditor's Report

The Board of Directors
The University of Arizona Health Plans – Family Care, Inc.

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 sheet as of December 31, 2016, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year ended December 31, 2016, 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 audit. We did not audit the financial statements of Cenpatico of Arizona, Inc. (COA), a corporation in which UFC has a 10% interest. The accompanying financial statements include an investment in COA of $6,869,588 as of December 31, 2016 and UFC's equity earnings in COA of $428,957 for the year then ended. These statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for COA, is based solely on the report of other auditors. We conducted our audit 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, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of The University of Arizona Health Plans – Family Care, Inc., a subsidiary of Banner Health, as of December 31, 2016, and the results of its operations and its cash flows for the year ended December 31, 2016, in accordance with accounting principles generally accepted in the United States of America.

Ernst + Young LLP

May 1, 2017

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

Balance Sheet

December 31, 2016

Assets	
Current assets:	
Cash and cash equivalent	$ 93,460,531
Reinsurance receivable	5,865,926
Capitation and supplemental revenues receivable	394,523
Reconciliation receivable	4,964,539
Other current assets	2,401,848
Total current assets	107,087,367
Reconciliation receivable	26,634
Other assets	6,961,449
Deferred tax asset	4,710,540
Total	$ 118,785,990
Liabilities and net assets	
Current liabilities:	
Accounts payable	$ 5,764,177
Due to affiliate	25,923,423
Medical claims payable	42,030,000
Reconciliation payable	1,794,818
Payment reform/shared savings payable	12,845,291
Other current liabilities	5,749,461
Income tax payable	3,597,707
Total current liabilities	97,704,877
Reconciliation payable	258,920
Total liabilities	97,963,797
Unrestricted net assets	20,822,193
Total	$ 118,785,990

See accompanying notes.

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

Statement of Revenues, Expenses and Changes in Net Assets

Year Ended December 31, 2016

Revenues and premium deficiency reserve, net:		
Capitation	$	425,643,317
PPC capitation		14,196,696
Delivery supplement		17,421,028
Adults </= 106 reconciliation settlement		(1,447,751)
PPC reconciliation settlement		(700,844)
Adults > 106 reconciliation settlement		2,249,398
PCP parity cost settlement		(346,973)
Investment income, including Cenpatico equity earnings		714,861
Premium deficiency reserve		(4,850,000)
Total revenues and premium deficiency reserve, net		452,879,732
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient		76,480,665
Hospital inpatient – behavioral health services		184,760
PPC — hospital inpatient		10,931,371
Total hospitalization expenses		87,596,796
Medical compensation:		
Primary care physician services		10,037,750
Behavioral health physician services		571,142
Referral physician services		49,070,697
FQHC/RHC services		32,331,045
Other professional services		17,367,524
PPC — physician services		1,705,079
PCP parity enhanced payment		(346,973)
Total medical compensation expenses		110,736,264
Other medical expenses:		
Emergency facility services		39,480,103
Pharmacy		93,703,920
Lab, X-ray, and medical imaging		19,813,206
Outpatient facility		48,835,744
Durable medical equipment		4,770,651
Dental		13,946,005
Transportation		19,177,223
Nursing facility, home health care		6,167,484
Physical therapy		3,393
Value based purchasing initiatives provider expenses		527,002
Behavorial health case management services		12,890
Behavorial health crisis intervention services		71,862
Behavioral health rehabilitation services		22,323
PPC — other		3,484,940
Total other medical expenses		250,016,746
Total health care expenses		448,349,806
Less:		
Reinsurance recoveries		19,799,193
Third-party liability, net of collection fees		2,432,934
Total net health care expenses		426,117,679

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

Statement of Revenues, Expenses and Changes in Net Assets (continued)

Year Ended December 31, 2016

Administrative expenses:		
Compensation	$	15,178,071
Data processing		4,271,047
Management fees		1,632,564
Interest		841,843
Occupancy		39,673
Depreciation		882,350
Marketing		21,926
Other		6,318,251
Total administrative expenses		29,185,725
Premium taxes		9,790,728
Total operating expenses		465,094,132
Operating loss, before income tax benefit		(12,214,400)
Income tax benefit		(4,437,310)
Net loss		(7,777,090)
Net assets, beginning of year		28,599,283
Net assets, end of year	$	20,822,193

See accompanying notes.

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

Statement of Cash Flows

Year Ended December 31, 2016

Operating activities	
Net loss	$ (7,777,090)
Adjustments to reconcile net loss to net cash used in operating activities:	
Increase in deferred tax asset	(821,119)
Changes in assets and liabilities:	
Reinsurance receivable	1,619,412
Capitation and supplemental revenues receivable	158,947
Other current assets	(1,379,320)
Reconciliation receivable	(2,687,074)
Accounts payable	1,308,821
Medical claims payable	(4,645,000)
Reconciliation payable	(8,382,563)
Payment reform/shared savings payable	7,619,190
Income tax payable	(3,616,191)
Other liabilities	4,203,011
Net cash used in operating activities	(14,398,976)
Investing activities	
Increase in other assets	(1,528,956)
Net cash used in investing activities	(1,528,956)
Financing activities	
Increase in due to affiliates	20,245,946
Net cash provided by financing activities	20,245,946
Net increase in cash and cash equivalent	4,318,014
Cash and cash equivalent at beginning of year	89,142,517
Cash and cash equivalent at end of year	$ 93,460,531

See accompanying notes.

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

Notes to Financial Statements

December 31, 2016

1. Organization and Operations

Organizational Structure

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, University of Arizona Health Network (UAHN), Banner Health (Banner), and the University of Arizona (UA) entered into a strategic affiliation through the acquisition of UAHN and its wholly owned subsidiaries by 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. As of February 28, 2015, Banner is the sole corporate member of UFC.

All of the Plan's revenues, except for investment income, were earned under its AHCCCS contract, which is subject to periodic renewal. In March 2013, UFC was awarded a new five-year contract with AHCCCS 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.

2. Summary of Significant Accounting Policies

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.

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

The carrying amounts for cash, short-term investment, reinsurance receivable, capitation and supplemental revenues receivables, reconciliation receivables and payables, other current assets, accounts payable, due to affiliate, medical claims payable, and other current liabilities approximate fair values due to the short-term nature of these accounts.

Cash and Cash Equivalent

UFC maintains cash in a bank account that frequently exceeds federally insured limits. To date, UFC has not experienced any losses on this account.

Cash and cash equivalent includes a money market amounting to $75,381,513 that is recorded at fair value.

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. There is a possibility that recorded estimates will change by a material amount in the near term.

Other Assets

UFC is a collaborator with Cenpatico 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. In 2015, UFC purchased 10% of the shares of COA for approximately $190,000. UFC has also guaranteed additional pro rata share contributions to allow COA to achieve a capital balance at or above 300% of its statutorily mandated capital. UFC funded this pro rata share commitment of $5,150,000 in October 2015 and $1,100,000 in August 2016. UFC, along with an affiliated insurance plan University Care Advantage, collectively hold a 20% interest in COA, and accordingly, accounts for the COA investment using the equity method of accounting. UFC's investment in COA amounted to $6,869,588 as of December 31, 2016, and is recorded within other assets on the balance sheet.

2. Summary of Significant Accounting Policies (continued)

Total assets, liabilities and net income of COA as of and for the year ended September 30, 2016 amounted to approximately $113,099,000, $43,725,000 and $8,419,000, 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. An accrual has been made for unpaid claims in process of review and for claims incurred but not received as of December 31, 2016. The amount of this liability is estimated by independent actuaries using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Because considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term.

Payment Reform/Shared Savings Program Settlement

AHCCCS has developed a 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 an incentive to participate in these arrangements. UFC is required to participate in these payment reform efforts as delineated by AHCCCS. For 2016, UFC has a payable to AHCCCS for approximately $12,800,000 related to this policy.

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 required a premium deficiency reserve of $4,850,000 at December 31, 2016, which is recorded in other current liabilities.

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. The monthly capitation revenues have been agreed upon by UFC and AHCCCS. Capitation revenues are recognized as revenue in the period to which health care coverage relates.

UFC received capitation payments for Prior Period Coverage (PPC) separately from its prospective capitation payments. PPC capitation payments are intended to cover healthcare costs incurred by individuals while waiting for enrollment in the Plan. PPC revenues are recognized in the month in which the member is eligible for coverage under the Plan.

Amounts receivable under these contracts are recorded as capitation and supplemental revenues receivable. Capitation rates are subject to adjustment based on national episodic/diagnostic risk. As such, there is a possibility that recorded amounts will change by a material amount in the near term.

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 Receivable (Payable) and Revenue (Contra-Revenue)

Certain AHCCCS programs are subject to settlement with AHCCCS based on the programs' net income or loss realized by UFC, based on a formula defined by the AHCCCS contract (reconciliation receivable (payable)). The reconciliation settlement period is based on the AHCCCS contract period of October 1 through September 30 and is subject to review and final settlement with AHCCCS. As of December 31, 2016, AHCCCS has settled the reconciliation receivable (payable) with UFC through the September 30, 2014 contract period. The estimated reconciliation receivable (payable) for contract years ended September 30, 2015, September 30, 2016, and through December 31, 2016, for the September 30, 2017, contract year, has been recorded as estimated reconciliation receivable (payable) on the balance sheet.

2. Summary of Significant Accounting Policies (continued)

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

Amounts due to (from) AHCCCS for the Prospective Tiered reconciliation settlement represents UFC's profit or loss for the prospective members. This reconciliation settlement represents 50% of UFC's profit in excess of 3% to 6% of capitation received and 100% of UFC's profit in excess of 6% of capitation received and 100% of UFC's loss in excess of 3% 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) AHCCCS for the Adults > 106% of the Federal Poverty Level (Adults > 106, formerly known as Newly Eligible Adults) reconciliation settlement represents UFC profit or loss for these members. The Adults > 106 reconciliation settlement represents UFC's profit or loss for these members in excess of 1% 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.

Administrative Expenses

Administrative expenses are recognized as incurred and consist of administrative expenses that directly relate to the AHCCCS program and a corporate allocation from Banner for general and administrative expenses. These expenses are repaid by UFC through intercompany settlements to Banner. These settlements are reflected as due to affiliate on the accompanying balance sheet.

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 capitation revenues and taxes remitted as an expense on the accompanying statement of revenues, expenses and changes in net assets.

2. Summary of Significant Accounting Policies (continued)

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 AHCCCS to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The gross capitation rates were reduced by the reinsurance cost. Under the AHCCCS program, risk of loss for inpatient claims is generally limited to an annual deductible of $25,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid at either 75% or 85%, 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.

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. However, nonrecognized subsequent events are disclosed.

UFC has evaluated events and transactions occurring subsequent to December 31, 2016 through May 1, 2017, the date of issuance of the accompanying financial statements. During this period, there were no events requiring recognition in the financial statements.

On March 3, 2017, UFC was awarded a long term care contract with AHCCCS with operations starting October 1, 2017. The contract award is to provide long-term care services to AHCCCS members enrolled in the Central and Southern Arizona service areas.

2. Summary of Significant Accounting Policies (continued)

New Accounting Standards

An accounting standard relating to balance sheet classification of deferred taxes was adopted by UFC as of December 31, 2016. The accounting standard requires companies to classify all deferred tax assets and liabilities as noncurrent on the balance instead of separating deferred taxes into current and noncurrent amounts. Accordingly, the December 31, 2016 balance sheet reports all deferred tax assets as long term.

Pending Accounting Pronouncements

In May 2014, the FASB issued a new revenue accounting standard, together along with subsequent amendments, updates and an extension of the effective date, (collectively the "New Revenue Standard"), which supersedes most existing revenue recognition guidance, including industry-specific healthcare guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

This five-step process will require significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. Additionally, and among other provisions, the New Revenue Standard requires expanded quantitative and qualitative disclosures, including disclosure about the nature, amount, timing and uncertainty of revenue.

The provisions of the New Revenue Standard are effective for annual periods beginning after December 15, 2017, including interim periods within those years by applying either the full retrospective method or the cumulative catch-up transition method. The full retrospective method requires application of the provisions of the New Revenue Standard for all periods presented while the cumulative catch-up transition method requires the application of the provisions of the New

2. Summary of Significant Accounting Policies (continued)

Revenue Standard as of the date of adoption with the cumulative effect of the retrospective application of the provisions as an adjustment through net assets. Currently, UFC anticipates adopting the provisions of the New Revenue Standard using the full retrospective method for all periods presented.

As UFC progresses with its implementation efforts to adopt the New Revenue Standard, management continues to evaluate and refine its estimates of the anticipated impacts it will have on its revenue recognition policies, procedures, financial position, results of operations, cash flows, financial disclosures and control framework. Specifically, management is continuing to evaluate its population of revenue sources to determine an appropriate level of stratification, as well as assess all of the potential effects the New Revenue Standard will have on variable consideration arising from settlements with third parties, including CMS.

3. Other Current Assets

Other current assets as of December 31, 2016, consist of the following:

Pharmacy rebate receivable	$ 693,557
Prepaid expenses and other	1,708,291
	$ 2,401,848

4. Other Assets

Other assets as of December 31, 2016, consist of the following:

Cenpatico investment	$ 6,869,588
Other long-term assets	91,861
	$ 6,961,449

5. Medical Claims Payable

Medical claims payable consists of the following at December 31, 2016:

Claims payable or pending approval	$ 28,282,938
Provisions for claims incurred but not yet reported	13,747,062
	$ 42,030,000

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 medical claims are paid or estimates adjusted, differences are recorded in the statement of revenues, expenses and changes in net assets. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts recorded. While the ultimate amount of claims paid is dependent on future developments, management is of the opinion that the accrued medical claims payable is adequate.

The following is a reconciliation of the accrued medical claims payable for the year ended December 31, 2016:

Beginning balance	$ 46,675,000
Incurred:	
Current	445,031,386
Prior	3,318,421
Total	448,349,806
Paid:	
Current	404,008,997
Prior	48,985,809
Total	452,994,806
Ending balance	$ 42,030,000

5. Medical Claims Payable (continued)

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities at any year-end are continually reviewed and re-estimated as information regarding actual claim payments become 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.

6. Related-Party Transactions

UFC purchases physician and hospital-based health care services for its members from Banner. During the year ending December 31 2016, UFC paid claims for medical expenses to Banner totaling approximately $87,000,000. In addition, UFC purchased administrative services from Banner, which are recognized as administrative expenses on the accompanying statement of revenues, expenses and changes in net assets.

At December 31, 2016, UFC had a payable to Banner of $25,923,423 recorded as due to affiliates.

7. Income Taxes

UFC recognizes liabilities for uncertain tax positions based on a two-step process. To the extent that a tax position does not meet a more-likely-than not level of certainty, no benefit is recognized in the financial statements. If a tax position meets the more-likely-than not level of certainty, it is recognized in the financial statements at the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. Interest and penalties related to unrelated tax benefits are recognized on liabilities recorded for uncertain tax positions and recorded in the provision for income taxes.

7. Income Taxes (continued)

Deferred tax assets and liabilities are recognized for temporary differences between the financial reporting basis and tax basis of assets and liabilities. UFC records a valuation allowance when it is more-likely-than not that the deferred tax assets will not be realized. Management determined that no valuation allowance was necessary at December 31, 2016. The following summarizes UFC's deferred tax assets as of December 31, 2016:

Deferred tax assets:	
Premium deficiency	$ 1,805,809
Accrued expenses	2,560,759
Accrued vacation	343,972
Total deferred tax assets	$ 4,710,540

A reconciliation of UFC's income taxes computed at the federal statutory rate to the income tax benefit for the year ended December 31, 2016 consists of the following:

Computed tax benefit at 34%	$ 4,152,896
State taxes net of federal benefit	385,408
Permanent items	(100,994)
Income tax benefit	$ 4,437,310

UFC's 2011 through 2016 tax years remain subject to examination for federal income tax purposes and 2010 through 2016 for state tax purposes.

In April 2017, UFC received notification from the Internal Revenue Service (IRS) that UFC's tax exemption status has been approved retroactive to May 7, 2013. Accordingly, UFC is now a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3). As a result of the tax exemption status, UFC will derecognize the deferred tax assets and related income tax liability accounts in April 2017 which will result in a reduction to net income of approximately $1,112,000.

8. 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. For the contract years ended September 30, 2012 through September 30, 2015, 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 sanctions. At December 31, 2016, UFC accrued estimated sanctions of $517,000 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 nonfinancial performance measures for contract periods ending after September 30, 2015 and through December 31, 2016. Compliance with these nonfinancial performance measures can be subject to future review by AHCCCS and may result in sanctions unknown or unasserted at this time. As of December 31, 2016, UFC's equity per member was below the required AHCCCS ratio. In April 2017, Banner provided a capital contribution of $2,500,000 which resulted in UFC being in compliance with the required equity per member AHCCCS ratio.

Performance Bond

UFC secured an annual performance bond in the amount of $35 million 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, 2017.

8. Commitments and Contingencies

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. 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.