# FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

The University of Arizona Health Plans – Family Care, Inc.
Years Ended December 31, 2017 and 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

Years Ended December 31, 2017 and 2016

## Contents

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# 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 sheets as of December 31, 2017 and 2016, and 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 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 $6,432,563 and $6,869,588 as of December 31, 2017 and 2016 and UFC's equity (losses) earnings in COA of $(437,025) and $428,957 for the years then ended, respectively. 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 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, based on our audits 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, 2017 and 2016, 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.

Ernst & Young LLP

April 30, 2018

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

Balance Sheets

| | December 31 2017 | December 31 2016 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalent | **$ 192,525,147** | $ 93,460,531 |
| Reinsurance receivable | **5,538,437** | 5,865,926 |
| Capitation and supplemental revenues receivable | **10,051,499** | 394,523 |
| Reconciliation receivable | **239,951** | 4,964,539 |
| Other current assets | **1,862,044** | 2,401,848 |
| Total current assets | **210,217,078** | 107,087,367 |
| | | |
| Reconciliation receivable | **4,792,564** | 26,634 |
| Other assets | **6,471,932** | 6,961,449 |
| Deferred tax asset | **–** | 4,710,540 |
| Total | **$ 221,481,574** | $ 118,785,990 |
| | | |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Accounts payable | **$ 3,713,149** | $ 5,143,430 |
| Due to affiliate | **55,808,644** | 25,923,423 |
| Medical claims payable | **81,880,171** | 42,650,747 |
| Reconciliation payable | **5,165,513** | 1,794,818 |
| Alternative payment model to providers | **744,696** | 223,020 |
| Other current liabilities | **5,641,054** | 5,749,461 |
| Income tax payable | **–** | 3,597,707 |
| Total current liabilities | **152,953,227** | 85,082,606 |
| | | |
| Reconciliation and payment reform payable | **22,827,943** | 12,881,191 |
| Total liabilities | **175,781,170** | 97,963,797 |
| | | |
| Commitments and contingencies | | |
| | | |
| Net assets | **45,700,404** | 20,822,193 |
| Total | **$ 221,481,574** | $ 118,785,990 |

*See accompanying notes.*

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

Statements of Revenues, Expenses and Changes in Net Assets

| | Year Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| **Revenue** | | |
| Capitation premiums | **$ 522,860,575** | $ 439,840,013 |
| Delivery supplemental | **16,512,935** | 17,421,028 |
| Reconciliation settlement, net | **(9,413,575)** | (246,170) |
| Investment income, net | **147,936** | 714,861 |
| Premium deficiency reserve | **700,000** | (4,850,000) |
| Total revenues | **530,807,871** | 452,879,732 |
| | | |
| **Health care expenses** | | |
| Hospitalization | **81,546,286** | 87,596,796 |
| Medical compensation | **116,160,689** | 110,736,264 |
| Ancillary and other medical services | **267,490,582** | 250,016,746 |
| Institutional | **22,574,645** | – |
| Home and community based serices | **21,235,502** | – |
| Case management services | **2,831,377** | – |
| Less reinsurance recoveries | **(23,024,721)** | (22,232,127) |
| Total healthcare expenses | **488,814,360** | 426,117,679 |
| | | |
| General and administrative expenses | **35,112,961** | 29,185,725 |
| Premium tax expense | **11,275,506** | 9,790,728 |
| Total operating expenses | **535,202,827** | 465,094,132 |
| Operating loss, before income tax (expense) benefit | **(4,394,956)** | (12,214,400) |
| Income tax (expense) benefit | **(1,112,833)** | 4,437,310 |
| Net loss | **(5,507,789)** | (7,777,090) |
| | | |
| Net assts, beginning of period | **20,822,193** | 28,599,283 |
| Contribution from affiliate | **30,386,000** | – |
| Net assets, end of period | **$ 45,700,404** | $ 20,822,193 |

*See accompanying notes.*

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

Statements of Cash Flows

| | Year Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| **Operating activities** | | |
| Net loss | **$ (5,507,789)** | $ (7,777,090) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Decrease (increase) in deferred tax asset | **4,710,540** | (821,119) |
| Changes in assets and liabilities: | | |
| Reinsurance receivable | **327,489** | 1,619,412 |
| Capitation and supplemental revenues receivable | **(9,656,976)** | 158,947 |
| Other current assets | **539,804** | (1,431,813) |
| Reconciliation receivable | **(41,342)** | (2,687,074) |
| Accounts payable and other liabilities | **(1,538,688)** | 4,891,085 |
| Medical claims payable | **39,229,424** | (4,024,253) |
| Reconciliation and payment reform payable | **13,317,447** | 4,239,708 |
| Shared savings payable | **521,676** | (5,003,081) |
| Income tax payable | **(3,597,707)** | (3,616,191) |
| Net cash provided by (used in) operating activities | **38,303,878** | (14,451,469) |
| | | |
| **Investing activities** | | |
| Decrease (increase) in other assets | **489,517** | (1,476,463) |
| Net cash provided by (used in) investing activities | **489,517** | (1,476,463) |
| | | |
| **Financing activities** | | |
| Increase in due to affiliate | **29,885,221** | 20,245,946 |
| Contribution from affiliate | **30,386,000** | – |
| Net cash provided by financing activities | **60,271,221** | 20,245,946 |
| | | |
| Net increase in cash and cash equivalent | **99,064,616** | 4,318,014 |
| Cash and cash equivalent at beginning of period | **93,460,531** | 89,142,517 |
| Cash and cash equivalent at end of period | **$ 192,525,147** | $ 93,460,531 |

*See accompanying notes.*

## 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 contracts 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 College 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 contracts, which are subject to periodic renewal. In March 2013, UFC was awarded a new five-year Acute-Care contract with AHCCCS through September 30, 2018. On October 1, 2017 UFC began operations for the AHCCCS Arizona Long Term Care System (ATLCS) contract which was awarded in March 2017. In March 2018, UFC was awarded a new AHCCCS Complete Care Contract that will be effective October 1, 2018 and extends through September 30, 2025. Continuation of the AHCCCS programs is dependent upon governmental policies. The loss of these contracts 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 and cash equivalents, 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 value 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.

At December 31, 2017 and 2016, cash and cash equivalent includes a money market account amounting to $75,966,474 and $75,381,513, respectively, 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. UFC recorded additional reinsurance recoveries amounting to $3,560,000 for the year ended December 31, 2017 relating to the 2016 contract year. 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 at December 31, 2017 and 2016 amounted to approximately $6,432,000 and $6,869,000 respectively, and is recorded within other assets on the balance sheet.

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

Total assets, liabilities and net loss of COA as of and for the year ended September 30, 2017 amounted to approximately $131,675,000, $66,606,000 and $5,308,000, respectively. Total assets, liabilities and net income of COA as of and for the year ended September 30, 2016 amounted to approximately $113,099,000, $43,724,000 and $8,589,000, 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, 2017 and 2016. The amount of this liability is estimated by independent actuaries using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Because considerable variability is inherent in such estimates, there is a possibility that recorded estimates will change by a material amount in the near term.

**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 $4,150,000 and $4,850,000 at December 31, 2017 and 2016, respectively, which are recorded in other current liabilities on the accompanying balance sheets.

**Capitation Premiums**

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.

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

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. Included in the December 31, 2017 capitation and supplemental revenue receivable is approximately $9,800,000 of additional capitation premium risk premiums to be received based on AHCCCS diagnostic risk evaluation. A change in estimate of approximately $7,800,000 was recorded for the year ended December 31, 2017 related to risk adjustment revenues received for the 2016 contract year, which increased revenue. There is a possibility that recorded amounts will change by a material amount in the near term.

**Delivery Supplement**

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 and 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. Through the report issuance date, AHCCCS has settled the reconciliation receivable (payable) with UFC through the September 30, 2016 contract period. Management has recorded a reduction to revenue of approximately $9,300,000 for the year ended December 31, 2017, relating to the settlement of prior contract years. The estimated reconciliation receivable (payable) for the September 30, 2018 contract year, has been recorded as estimated reconciliation receivable (payable) on the accompanying balance sheets.

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. As of December 31, 2017 and 2016, UFC has a payable to AHCCCS related to this policy of approximately $17,739,000 and $12,845,000, respectively, which is included in reconciliation and payment reform payable on the accompanying balance sheets.

**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, 100% of UFC's profit in excess of 6% of capitation received and 100% of UFC's loss in excess of 3% of capitation received. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) AHCCCS for the Adults > 106% of the Federal Poverty Level (Adults > 106, formerly known as Newly Eligible Adults) reconciliation settlement represents 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 received. Because the Adults > 106 reconciliation settlement is subject to change based on claims experience, there is a possibility that recorded reconciliation settlements will change by a material amount in the near term.

**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 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 capitation revenues and taxes remitted as an expense on the accompanying statements 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 for the acute care contract and $20,000 or $30,000 for the ALTCS contract. 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, 2017 through April 30, 2018, the date of issuance of the accompanying financial statements.

On March 3, 2018, UFC was awarded a Complete Care Contract with AHCCCS with operations starting October 1, 2018. The contract award is to provide physical and behavioral care services to AHCCCS members enrolled in the Central and Southern Arizona service areas.

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

**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.

Under the New Revenue Standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. UFC performed an evaluation over each of its major revenue streams under the New Revenue Standard, including evaluation whether any of the revenue streams included variable consideration as well as any potential constraints to the estimate of the variable consideration. The New Revenue Standard also requires enhanced disclosures related to the disaggregation of revenue and other disclosures about contracts with customers, including revenue recognition.

UFC adopted the new revenue standard on January 1, 2018 and has elected to use the modified retrospective adoption method. The modified retrospective adoption method requires a company to record the transition adjustment for the New Revenue Standard, if any, as a cumulative effect adjustment to the beginning net assets recorded as of the date of adoption. UFC has determined that the transition adjustment is not material to the financial statements.

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

In August 2016, the FASB issued a new financial statement accounting standard for not-for-profit entities. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for fiscal years beginning after December 15, 2017. UFC elected to continue to use the indirect cash flow method and will provide additional disclosure relating to liquidity and functional expenditures starting in 2018.

### Reclassification

The 2016 financial statements have been reclassified to conform to the 2017 presentation, primarily relating to the reclassification of claim loss expenses of $620,747 from accounts payable to medical claims payable and reclassification of payment reform payable amounting to $12,622,271 from current liabilities to long term liabilities.

## 3. Other Current Assets

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

| | 2017 | 2016 |
|---|---|---|
| Pharmacy rebate receivable | **$ 348,091** | $ 766,100 |
| Prepaid expenses and other | **413,219** | 293,302 |
| Third party liability receivable | **161,412** | 51,382 |
| Due from vendors | **924,660** | 1,291,064 |
| Share of cost receivable | **14,662** | – |
| | **$ 1,862,044** | $ 2,401,848 |

## 4. Other Assets

Other assets as of December 31 consist of the following:

| | 2017 | 2016 |
|---|---|---|
| Cenpatico investment | **$ 6,432,563** | $ 6,869,588 |
| Other long-term assets | **39,369** | 91,861 |
| | **$ 6,471,932** | $ 6,961,449 |

## 5. Medical Claims Payable

Medical claims payable consists of the following at December 31:

| | **2017** | **2016** |
|---|---|---|
| Claims payable or pending approval | **$ 40,311,506** | $ 28,903,685 |
| Provisions for claims incurred but not yet reported | **41,568,665** | 13,747,062 |
| | **$ 81,880,171** | $ 42,650,747 |

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:

| | **2017** | **2016** |
|---|---|---|
| Beginning balance | **$ 42,650,747** | $ 46,675,000 |
| Incurred: | | |
| Current | **510,608,848** | 445,031,385 |
| Prior | **1,230,233** | 3,318,421 |
| Total | **511,839,081** | 448,349,806 |
| Paid: | | |
| Current | **428,728,677** | 403,388,250 |
| Prior | **43,880,980** | 48,985,809 |
| Total | **472,609,657** | 452,374,059 |
| Ending balance | **$ 81,880,171** | $ 42,650,747 |

## 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. Positive amounts reported for incurred, related to prior years, result from claims being adjudicated and paid for amounts greater than originally estimated.

## 6. Related-Party Transactions

UFC purchases physician and hospital-based health care services for its members from Banner. During the years ending December 31 2017 and 2016, UFC paid claims for medical expenses to Banner totaling approximately $76,874,000 and $87,396,000, respectively.

UFC purchases administrative services from Banner, which are recognized as administrative expenses on the accompanying statement of revenues, expenses and changes in net assets. For the years ended December 31, 2017 and 2016, UFC incurred approximately $26,400,000 and $15,400,000, respectively, of corporate allocation from Banner and affiliates for overhead administrative support.

At December 31, 2017 and 2016, UFC had a payable to Banner recorded as due to affiliate of $55,808,644 and $25,923,423, respectively.

## 7. Income Taxes

In April 2017, UFC received notification from the Internal Revenue Service (IRS) that UFC's tax exemption status had 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 derecognized the deferred tax assets and related income tax liability accounts in April 2017, which resulted in an increase to income tax expense of $1,112,833 for the year ended December 31, 2017.

On December 22, 2017, the Tax Cuts and Jobs Act was enacted (Enactment), which for tax exempt entities, requires certain organizations to categorize certain fringe benefit expenses as a source of unrelated business income and report income or loss on unrelated business activities on an activity-by-activity basis, among other provisions.

**7. Income Taxes (continued)**

UFC has not recorded any expense or accrued for any related expense for any uncertain tax positions. UFC's 2014 through 2017 tax years remain subject to examination for federal income tax purposes, whereas the 2013 through 2017 tax years remain subject to examination for state taxing jurisdictions in which UFC operates.

**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, 2017, 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, 2017. 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. During 2017, Banner and affiliated entities provided capital contributions of $30,386,000 which resulted in UFC being in compliance with the required equity per member AHCCCS ratio. As of December 31, 2017, UFC's equity per member was in compliance with the AHCCCS requirement.

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

**Performance Bond**

UFC secured annual performance bonds in the amounts of $40 million and $25 million with an unrelated third-party insurance company to satisfy the performance bond requirement of UFC's AHCCCS contracts. The bonds satisfy UFC's contractual obligation as prescribed by AHCCCS. The current performance bonds expire September 30, 2018.

**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.

# Supplementary Information

Ernst & Young LLP
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# Report of Independent Auditors on Supplementary Information

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

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

Ernst & Young LLP

April 30, 2018

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

Balance Sheet – Acute Contract and ALTCS Contract

December 31, 2017

| | Acute | ALTCS | Total |
|---|---|---|---|
| **Assets** | | | |
| Current assets: | | | |
| Cash and cash equivalent | $ 142,103,025 | $ 50,422,122 | $ 192,525,147 |
| Reinsurance receivable | 5,218,227 | 320,210 | 5,538,437 |
| Capitation and supplemental revenues receivable | 10,051,499 | – | 10,051,499 |
| Reconciliation receivable | 239,951 | – | 239,951 |
| Other current assets | 1,688,173 | 173,871 | 1,862,044 |
| Total current assets | 159,300,875 | 50,916,203 | 210,217,078 |
| | | | |
| Reconciliation receivable | 4,792,564 | – | 4,792,564 |
| Other assets | 6,471,932 | – | 6,471,932 |
| Total | $ 170,565,371 | $ 50,916,203 | $ 221,481,574 |
| | | | |
| **Liabilities and net assets** | | | |
| Current liabilities: | | | |
| Accounts payable | $ 3,472,567 | $ 240,582 | $ 3,713,149 |
| Due to affiliate | 53,835,236 | 1,973,408 | 55,808,644 |
| Medical claims payable | 46,902,223 | 34,977,948 | 81,880,171 |
| Reconciliation payable | 5,165,513 | – | 5,165,513 |
| Alternative payment model to providers | 744,696 | – | 744,696 |
| Other current liabilities | 5,500,994 | 140,060 | 5,641,054 |
| Total current liabilities | 115,621,229 | 37,331,998 | 152,953,227 |
| | | | |
| Reconciliation and payment reform payable | 22,206,934 | 621,009 | 22,827,943 |
| Total liabilities | 137,828,163 | 37,953,007 | 175,781,170 |
| | | | |
| Net assets | 32,737,208 | 12,963,196 | 45,700,404 |
| Total | $ 170,565,371 | $ 50,916,203 | $ 221,481,574 |

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

Statement of Revenues and Expenses – Acute Contract and ALTCS Contract

Year Ended December 31, 2017

| | Acute | ALTCS | Total |
|---|---|---|---|
| **Revenue** | | | |
| Capitation premiums | $ 461,125,565 | $ 61,735,010 | $ 522,860,575 |
| Delivery supplemental | 16,512,935 | – | 16,512,935 |
| Reconciliation settlement, net | (9,452,618) | 39,043 | (9,413,575) |
| Investment income, net | 147,936 | – | 147,936 |
| Premium deficiency reserve | 700,000 | – | 700,000 |
| Total revenues | 469,033,818 | 61,774,053 | 530,807,871 |
| | | | |
| **Health care expenses** | | | |
| Hospitalization | 79,255,559 | 2,290,727 | 81,546,286 |
| Medical compensation | 113,164,215 | 2,996,474 | 116,160,689 |
| Ancillary and other medical services | 255,450,254 | 12,040,328 | 267,490,582 |
| Institutional | – | 22,574,645 | 22,574,645 |
| Home and community based serices | – | 21,235,502 | 21,235,502 |
| Case management services | – | 2,831,377 | 2,831,377 |
| Less reinsurance recoveries | (22,704,511) | (320,210) | (23,024,721) |
| Total healthcare expenses | 425,165,517 | 63,648,843 | 488,814,360 |
| | | | |
| General and administrative expenses | 29,815,883 | 5,297,078 | 35,112,961 |
| Premium tax expense | 10,024,571 | 1,250,935 | 11,275,506 |
| Total operating expenses | 465,005,971 | 70,196,856 | 535,202,827 |
| Operating income (loss), before income tax expense | 4,027,847 | (8,422,803) | (4,394,956) |
| Income tax expense | 1,112,833 | – | 1,112,833 |
| Net income (loss) | $ 2,915,014 | $ (8,422,803) | $ (5,507,789) |

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

## Statement of Cash Flows – Acute Contract and ALTCS Contract

Year Ended December 31, 2017

| | Acute | ALTCS | Total |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) | $ 2,915,015 | $ (8,422,804) | $ (5,507,789) |
| Adjustments to reconcile net loss to | | | |
| net cash provided by operating activities: | | | |
| Decrease in deferred tax asset | 4,710,540 | – | 4,710,540 |
| Changes in assets and liabilities: | | | |
| Reinsurance receivable | 647,699 | (320,210) | 327,489 |
| Capitation and supplemental revenues receivable | (9,656,976) | – | (9,656,976) |
| Other current assets | 713,675 | (173,871) | 539,804 |
| Reconciliation receivable | (41,342) | – | (41,342) |
| Accounts payable and other liabilities | (1,919,330) | 380,642 | (1,538,688) |
| Medical claims payable | 4,251,476 | 34,977,948 | 39,229,424 |
| Reconciliation and payment reform payables | 13,218,114 | 621,009 | 13,839,123 |
| Income tax payable | (3,597,707) | – | (3,597,707) |
| Net cash provided by operating activities | 11,241,164 | 27,062,714 | 38,303,878 |
| | | | |
| **Investing activities** | | | |
| Decrease in other assets | 489,517 | – | 489,517 |
| Net cash provided by investing activities | 489,517 | – | 489,517 |
| | | | |
| **Financing activities** | | | |
| Increase in due to affiliate | 27,911,813 | 1,973,408 | 29,885,221 |
| Contribution from affiliate | 9,000,000 | 21,386,000 | 30,386,000 |
| Net cash provided by financing activities | 36,911,813 | 23,359,408 | 60,271,221 |
| | | | |
| Net increase in cash and cash equivalent | 48,642,494 | 50,422,122 | 99,064,616 |
| Cash and cash equivalent at beginning of period | 93,460,531 | – | 93,460,531 |
| Cash and cash equivalent at end of period | $ 142,103,025 | $ 50,422,122 | $ 192,525,147 |

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

Detail of Sub-Capitated Expenses

| | Year Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Dental expenses | **$ 17,342,281** | $ 13,926,287 |
| Primary care physician services | **167,890** | 299,065 |
| Total sub-capitated expenses | **$ 17,510,171** | $ 14,225,352 |

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