

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

Financial Statements  
With Independent Auditor's Report Thereon  
June 30, 2014 and 2013

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## Independent Auditor's Report

To the Board of Directors  
The University of Arizona Health Network  
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 component unit of The University of Arizona Health Network (the Corporation or UAHN), as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise UFC's financial statements, as listed in the table of contents.

### 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 component unit of The University of Arizona Health Network, as of June 30, 2014 and 2013, 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 described more fully in Note 1, UFC is a component unit of UAHN and was formerly reported on and operated as a contract of University Physicians Health Plans—University Family Care, LLC (UPHP-UFC), an operating division of University Physicians Healthcare (UPH). The accompanying financial statements present only UFC and do not purport to, and do not, present fairly the financial position of UAHN or UPH and their changes in net position and their cash flows in conformity with accounting principles generally accepted in the United States of America.

**Other Matters**

Management has omitted a management's discussion and analysis for UFC that accounting principles generally accepted in the United States of America require to be submitted to supplement the basic financial statements. Such missing information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historic context. Our opinion on the basic financial statements is not affected by this missing information.



Minneapolis, Minnesota  
December 19, 2014

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

Balance Sheets  
June 30, 2014 and 2013

<b>Assets</b>	<b>2014</b>	<b>2013</b>
Current Assets		
Reinsurance receivable	\$ 6,931,037	\$ 8,258,388
Capitation and supplemental revenues receivable	312,583	138,697
Due from affiliate	75,531,888	42,374,434
Reconciliation receivable	449,271	543,106
Other current assets	711,395	876,177
<b>Total current assets</b>	<b>83,936,174</b>	<b>52,190,802</b>
Reconciliation Receivable	10,627,813	349,710
Other Assets	223,094	262,464
<b>Total</b>	<b>\$ 94,787,081</b>	<b>\$ 52,802,976</b>
 <b>Liabilities and Net Position</b>		
Current Liabilities		
Accounts payable	\$ 3,741,499	\$ 759,278
Medical claims payable	44,302,576	20,574,427
Reconciliation payable	2,110,228	2,599,660
Other current liabilities	4,880,226	749,542
<b>Total current liabilities</b>	<b>55,034,529</b>	<b>24,682,907</b>
Reconciliation Payable	3,172,978	157,805
<b>Total liabilities</b>	<b>58,207,507</b>	<b>24,840,712</b>
Commitments and Contingencies		
Unrestricted Net Position	36,579,574	27,962,264
<b>Total</b>	<b>\$ 94,787,081</b>	<b>\$ 52,802,976</b>

See Notes to Financial Statements.

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

Statements of Revenues, Expenses and Changes in Net Position  
Years Ended June 30, 2014 and 2013

	2014	2013
Revenues, net:		
Capitation	\$ 289,123,926	\$ 178,688,967
PPC capitation	13,341,705	4,626,285
Delivery supplement	18,543,731	12,713,145
TWG reconciliation settlement	(4,714)	839,312
PPC reconciliation settlement	5,203,563	335,501
Prospective Tiered reconciliation settlement	(2,470,281)	-
Newly Eligible Adults reconciliation settlement	(874,308)	-
PCP Parity cost settlement	5,270,261	-
<b>Total revenues, net</b>	<b>328,133,883</b>	<b>197,203,210</b>
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	54,015,863	39,606,934
PPC—hospital inpatient	9,854,731	2,686,563
<b>Total hospitalization expenses</b>	<b>63,870,594</b>	<b>42,293,497</b>
Medical compensation:		
Primary care physician services	16,327,280	10,674,847
Referral physician services	36,424,753	24,498,470
Other professional services	11,659,550	6,554,467
PPC—physician services	2,003,070	701,892
PCP Parity enhanced payment	5,270,261	-
<b>Total medical compensation expenses</b>	<b>71,684,914</b>	<b>42,429,676</b>
Other medical expenses:		
Emergency facility services	31,160,414	18,388,470
Pharmacy	50,877,146	34,695,555
Lab, X-ray and medical imaging	13,347,452	7,573,296
Outpatient facility	33,041,290	21,891,413
Durable medical equipment	2,395,436	1,941,849
Dental	11,357,782	7,611,465
Transportation	14,311,042	9,308,960
Nursing facility, home health care	4,070,890	2,295,428
Physical therapy	3,654	(12,982)
PPC—other	5,102,205	1,330,739
<b>Total other medical expenses</b>	<b>165,667,311</b>	<b>105,024,193</b>
<b>Total health care expenses</b>	<b>301,222,819</b>	<b>189,747,366</b>
Less:		
Reinsurance recoveries	11,893,997	13,893,284
Third-party liability, net of collection fees	1,125,235	3,207,458
<b>Total net health care expenses</b>	<b>288,203,587</b>	<b>172,646,624</b>

(Continued)

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

Statements of Revenues, Expenses and Changes in Net Position (Continued)  
 Years Ended June 30, 2014 and 2013

	2014	2013
Administrative expenses:		
Compensation	13,060,442	9,568,406
Data processing	2,107,229	1,164,920
Management fees	2,366,407	2,075,721
Interest	17,284	14,487
Occupancy	133,043	113,403
Depreciation	750,316	579,868
Marketing	68,511	30,300
Other	6,072,646	3,951,585
<b>Total administrative expenses</b>	<b>24,575,878</b>	17,498,690
Premium taxes	6,737,108	4,190,028
<b>Total operating expenses</b>	<b>319,516,573</b>	194,335,342
<b>Operating gain</b>	<b>8,617,310</b>	2,867,868
Net position, beginning	27,962,264	25,094,396
Net position, ending	<b>\$ 36,579,574</b>	<b>\$ 27,962,264</b>

See Notes to Financial Statements.

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

Statements of Cash Flows  
Years Ended June 30, 2014 and 2013

	2014	2013
Cash Flows From Operating Activities		
Cash received for services provided and other operating activities	\$ 334,812,836	\$ 211,177,567
Cash paid to providers and facilities	(277,494,670)	(190,094,688)
Cash paid for supplies, purchased services and other	(24,160,712)	(21,219,630)
<b>Net cash provided by (used in) operating activities</b>	<b>33,157,454</b>	<b>(136,751)</b>
Cash Flows From Investing Activities		
Change in due from affiliate	(33,157,454)	136,751
<b>Net change in cash and cash equivalents</b>	<b>-</b>	<b>-</b>
Cash and Cash Equivalents, beginning	-	-
Cash and Cash Equivalents, ending	<u>\$ -</u>	<u>\$ -</u>
Reconciliation of Operating Gain to Net Cash Provided by (Used in) Operating Activities		
Operating gain	\$ 8,617,310	\$ 2,867,868
Adjustments to reconcile operating gain to net cash provided by (used in) operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	1,327,351	(1,758,922)
Capitation and supplemental revenues receivable	(173,886)	2,258
Other current assets	164,782	256,386
Reconciliation receivable	(10,184,268)	(410,735)
Other assets	39,370	(97,671)
Accounts payable	2,982,221	(401,273)
Medical claims payable	23,728,149	(347,322)
Reconciliation payable	2,525,741	(865,126)
Other current liabilities	4,130,684	617,786
<b>Net cash provided by (used in) operating activities</b>	<b>\$ 33,157,454</b>	<b>\$ (136,751)</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 (the Corporation or 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 the Corporation, UMC's and UPH's bylaws were changed, designating the Corporation as UMC's and UPH's sole member and granting the Corporation certain reserved power and authority. UPH is a component unit of UAHN. UFC is governed by the Board of UPH.

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 with UPHP-UFC and did not have operations prior to the merger. These financial statements are reported on a comparative basis and present the financial position, and revenues, expenses and changes in net position of UFC and UPHP-UFC based on the period of their existence as described above. The accompanying financial statements present the financial position and changes in net position of UFC only and do not represent the financial position and changes in net position of UAHN or UPH.

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 Governmental Accounting Standards Board (GASB) principles and has prepared UFC's financial statements on the accrual basis of accounting, using the economic resources measurement focus.

**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. Actual results could differ from those estimates.

**Cash and cash equivalents:** UAHN maintains all cash and cash equivalents generated by UFC. Therefore, there are no cash and cash equivalents presented in the accompanying balance sheet. The balance is maintained in due from affiliate and is due on demand from UAHN. As a result, UAHN assumes any credit risk associated with the cash and cash equivalents held on behalf of UFC.

**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 \$347,000 during 2014 and approximately \$245,000 during 2013 that represents an increase in amounts over the 2013 and 2012 estimates, respectively.

## 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)

**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, 2014 or 2013.

**Unrestricted net position:** Unrestricted net position is the remaining net position that does not meet the definition of restricted or invested in capital assets in accordance with GASB Statement No. 63—*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

**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:** 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 Title XIX Waiver Group (TWG) reconciliation settlement represents UFC's profit or loss for these members in excess of 3 percent for the population. For the contract year ending September 30, 2014, UFC is no longer subject to reconciliation settlement on this population. For the contract year ended September 30, 2013, the TWG 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 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.

## 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)

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, 2014 and 2013, this tiered reconciliation settlement represents UFC's profit for these members in excess of 3 percent to 9 percent or loss for these members in excess of 3 percent to 6 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 Newly Eligible Adults reconciliation settlement represents UFC profit or loss for the newly eligible adult members. For the contract year ending September 30, 2014, this reconciliation settlement represents UFC's profit or loss for these members in excess of 1 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.

**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. 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.

**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 UPH.

**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 position.

**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 is the surviving domestic not-for-profit corporation with UPH as its sole corporate member. 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, 2010, for federal and June 30, 2009, 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.

## 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)

**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 UPH 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 for 2014 and \$20,000 for 2013 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.

**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.

In June 2014, the Corporation and the University of Arizona executed a Principles of Agreement document with Banner Health to create a statewide health care organization and a comprehensive new model for academic medicine. This agreement is in the process of being formalized into a final definitive agreement that is expected to be executed in December 2014. The definitive agreement must also be approved by the Arizona Board of Regents and the boards of directors of the Corporation and Banner.

UFC has evaluated events and transactions occurring subsequent to June 30, 2014, through December 19, 2014, the date of issuance of the financial statements. During this period, there were no events requiring recognition in the financial statements, other than those noted above. Additionally, there were no nonrecognized subsequent events requiring disclosure.

#### Note 3. Medical Claims Payable

Medical claims payable consists of the following at June 30, 2014 and 2013:

	2014	2013
Claims payable or pending approval	\$ 26,176,012	\$ 7,536,772
Provisions for claims incurred but not yet reported	18,126,564	13,037,655
	<u>\$ 44,302,576</u>	<u>\$ 20,574,427</u>

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

### Notes to Financial Statements

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

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 following is a reconciliation of the accrued claims payable for the years ended June 30, 2014 and 2013:

	2014	2013
Beginning balance	\$ 20,574,427	\$ 20,921,749
Incurred:		
Current	301,739,239	189,238,442
Prior	(516,420)	508,924
Total	301,222,819	189,747,366
Paid:		
Current	257,436,663	168,664,015
Prior	20,058,007	21,430,673
Total	277,494,670	190,094,688
Ending balance	\$ 44,302,576	\$ 20,574,427

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 UPH and UMC. During 2014 and 2013, UFC paid claims for medical expenses to UPH and UMC totaling \$42,442,627 and \$36,179,486, respectively. In addition, UFC purchases administrative services from UPH, which are recognized as administrative expenses in the statements of revenues, expenses and changes in net position.

At June 30, 2014 and 2013, UFC had a receivable totaling \$75,531,888 and \$42,374,434, respectively, due from UAHN.

## 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. Effective October 1, 2013, UFC achieved compliance with certain of these prerequisites due to University Care Advantage, Inc. (UCA), a related party through common control, holding a Medicare Advantage Special Needs Plan (Medicare SNP) contract with the Centers for Medicare & Medicaid Services. The UCA Medicare SNP contract was not renewed for calendar year 2014, and as a result, UFC was no longer in compliance with this AHCCCS requirement as of January 1, 2014. This lack of compliance resulted in sanctions of \$375,000, but did not result in termination of the AHCCCS contract. In fiscal year 2014, UFC recognized and paid \$375,000 for this sanction.

During fiscal year 2014, for the contract year ended September 30, 2012, management determined that UFC did not meet certain AHCCCS nonfinancial performance measures, resulting in sanctions of \$300,000. 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 of an estimated \$150,000 for the contract year ended September 30, 2013. At June 30, 2013 and 2014, UFC accrued \$450,000 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 measures for periods after September 30, 2013. 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:** UPH secured an annual performance bond on behalf of UFC in the amount of \$29,000,000 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, 2015.

**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.