Audited Financial Statements and Other Supplementary Information

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)
Year Ended September 30, 2013
With Report of Independent Auditors

Ernst & Young LLP

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Report of Independent Auditors

The Board of Directors
Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

We have audited the accompanying financial statements of Health Choice Arizona, a division of Health Choice Arizona, Inc., which is a wholly owned subsidiary of IASIS Healthcare LLC, which comprise the balance sheet as of September 30, 2013, and the related statement of earnings, changes in equity of parent and cash flows for the year 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 conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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 conducted our audit in accordance with auditing standards generally accepted in the United States. 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Health Choice Arizona at September 30, 2013, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The details of the attached schedules (pages 14-20) of other supplementary information 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 not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on it.

Ernst + Young LLP

January 24, 2014

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Balance Sheet

September 30, 2013

Assets	
Current assets:	
AHCCCS receivables, net	$ 6,996,782
Due from affiliates	291,675,681
Other current assets	4,526,478
Total current assets	303,198,941
Goodwill	5,756,914
Other intangible assets, net of accumulated amortization of $27,000,000	18,000,000
Total assets	$ 326,955,855
Liabilities and equity of Parent	
Current liabilities:	
Accounts payable and accrued expenses	$ 145,647
Medical claims payable	50,703,664
Total current liabilities	50,849,311
Equity:	
Equity of Parent	276,106,544
Total liabilities and equity of Parent	$ 326,955,855

See accompanying notes.

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Statement of Earnings

Year Ended September 30, 2013

Revenues	
Capitation premiums	$ 469,310,946
Delivery supplemental premiums	34,293,990
Total revenues	503,604,936
Medical expenses	
Hospitalization, net	98,414,429
Medical compensation	118,450,679
Other medical, net	206,535,095
Total medical expenses	423,400,203
Administrative expenses	49,880,419
Total expenses	473,280,622
Earnings before income taxes	30,324,314
Income taxes	10,610,282
Net earnings	$ 19,714,032

See accompanying notes.

Health Choice Arizona
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Statement of Changes in Equity of Parent

Year Ended September 30, 2013

	Contributed Capital	Retained Earnings	Totals
Balance at September 30, 2012	$ 85,875,813	$ 170,516,699	$ 256,392,512
Net earnings	–	19,714,032	19,714,032
Balance at September 30, 2013	$ 85,875,813	$ 190,230,731	$ 276,106,544

See accompanying notes.

Health Choice Arizona
(A Division of Health Choice Arizona, Inc.)

Statement of Cash Flows

Year Ended September 30, 2013

Operating activities	
Net earnings	$ 19,714,032
Adjustments to reconcile net earnings to net cash used in operating activities:	
Amortization	3,000,000
Changes in operating assets and liabilities:	
AHCCCS receivables, net	(25,244,163)
Other current assets	(2,965,076)
Accounts payable and accrued expenses	145,647
Medical claims payable	(2,841,624)
Net cash used in operating activities	(8,191,184)
Financing activities	
Change in due from affiliates	8,191,184
Net cash provided by financing activities	8,191,184
Change in cash and cash equivalents	–
Cash and cash equivalents, beginning of year	–
Cash and cash equivalents, end of year	$ –

See accompanying notes.

1. Organization and Basis of Presentation

Health Choice Arizona (the Plan or Health Choice) is a division of Health Choice Arizona, Inc. (the Parent), which is a wholly owned subsidiary of IASIS Healthcare LLC (IASIS). IASIS is a hospital management company that also owns and operates 16 acute care hospital facilities and one behavioral health hospital facility in seven states. The Plan is a prepaid Medicaid managed health plan that derives all of its revenue through a contract with the Arizona Health Care Cost Containment System (AHCCCS) to provide specified healthcare services to qualified Medicaid enrollees through contracts with providers, including affiliates of IASIS. AHCCCS is the state agency that administers Arizona's Medicaid program. The contract requires the Plan to arrange for healthcare services for enrolled Medicaid patients in exchange for fixed monthly premiums, based on negotiated per capita member rates, and supplemental payments from AHCCCS. These services are provided regardless of the actual costs incurred to provide these services. The Plan receives reinsurance and other supplemental payments from AHCCCS to cover certain costs of healthcare services that exceed certain defined thresholds.

Under the contract, the Plan subcontracted with hospitals, physicians and other medical providers, including affiliates of IASIS, within Arizona and surrounding states to provide services to its enrollees in Apache, Coconino, Maricopa, Mohave, Navajo, Pima, Yuma, La Paz and Santa Cruz counties.

The Plan's contract with AHCCCS was set to expire September 30, 2013. On March 25, 2013, Health Choice was awarded a new contract by AHCCCS. The new contract, which covers enrollees in Apache, Coconio, Gila, Maricopa, Mohave, Navajo, Pima and Pinal counties, commenced on October 1, 2013, and has an initial term of three years, and includes two-one year renewal options at the discretion of AHCCCS. The contract is terminable without cause on 90 days' written notice, or for cause upon written notice if the Plan fails to comply with any term or condition of the contract or fails to take corrective action as required to comply with the terms of the contract. Additionally, AHCCCS can terminate the contract in the event of the unavailability of state or federal funding.

2. Summary of Significant Accounting Policies

Due From Affiliates

Due from affiliates mostly represents the net excess of funds transferred to the centralized cash management account of IASIS over funds transferred to or paid on behalf of the Plan. Due from

2. Summary of Significant Accounting Policies (continued)

affiliates balances are readily available to the Plan for settlement of the Plan's current liabilities as they become due. Generally, this balance is decreased by automatic cash transfers from the account to reimburse the Plan's bank accounts for certain expenses. Generally, the balance is increased through daily cash deposits by the Plan to the centralized cash management account of IASIS. Interest income is not earned on outstanding balances due from affiliates.

Goodwill

Pursuant to accounting guidance related to goodwill and other intangible assets, goodwill is not amortized but is subject to annual impairment reviews or more often if events or circumstances indicate it may be impaired. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Plan has completed its annual impairment test for the 2013 fiscal year, which resulted in no impairment.

Long-Lived Assets

The primary components of the Plan's long-lived assets are intangible assets. When events, circumstances or operating results indicate that the carrying values of certain long-lived assets (excluding goodwill) that are expected to be held and used might be impaired, the Plan considers the recoverability of assets to be held and used by comparing the carrying amount of the assets to the undiscounted value of future net cash flows expected to be generated by the assets. If assets are identified as impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets as determined by independent appraisals or estimates of discounted future cash flows.

Intangible Assets

Other intangible assets consist solely of the Plan's contract with AHCCCS, which is amortized over a period of 15 years, which approximates the contract's estimated useful life, including assumed renewal periods. Amortization of intangible assets totaled $3,000,000 for the year ended September 30, 2013, and is included in administrative expenses in the accompanying statement of earnings.

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

Capitation premiums are recognized as revenue in the month that members of the Plan are entitled to healthcare services. Capitation premiums are subject to an episodic/diagnostic risk factor adjustment. Health Choice receives capitation payments for Prior Period Coverage (PPC) separately from its prospective capitation payments. PPC capitation payments are intended to cover those healthcare costs incurred by individuals while they are awaiting enrollment in the Plan. PPC revenues are recognized in the month in which the member is eligible for coverage under the Plan. AHCCCS limits the profitability and loss that health plans may recognize for both the Title XIX Waiver Group (TWG) and PPC member populations to 2%. All other prospective risk groups are subject to a tiered prospective profit reconciliation for the contract year ending September 30, 2013, based upon prospective expenses and prospective net capitation. As of September 30, 2013, the Plan had an estimated net receivable of approximately $6,997,000 for all risk groups.

Delivery supplemental premiums are payments received per newborn delivery and are intended by AHCCCS to cover the cost of maternity care for qualified pregnant women. Such premiums are billed and recognized in the month that delivery occurs.

Medical Expenses

Monthly capitation payments to primary care physicians and other healthcare providers are expensed in the month services are contracted to be performed. Claims expense for non-capitated arrangements is accrued as services are rendered by hospitals, physicians and other healthcare providers during the year. Medical compensation includes primary care and specialty physician services. Other medical expenses include hospital outpatient services and other ancillary services such as radiology and lab.

Medical claims payable includes claims received but not paid and an estimate of claims incurred but not reported. Incurred but not reported claims are estimated using a combination of historical claims experience (including severity and payment lag time) and other actuarial analysis including number of enrollees, age of enrollees and certain enrollee health indicators to predict the cost of healthcare services provided to enrollees during any given period. While management believes that its estimation methodology effectively captures trends in medical claims costs, actual payments could differ significantly from estimates given changes in the healthcare cost

2. Summary of Significant Accounting Policies (continued)

structure or adverse experience. During the year ended September 30, 2013, the Plan reduced medical claims payable related to estimates for prior periods that reduced medical claims expense by approximately $1,494,000. In order to evaluate the appropriateness of medical claims payable at September 30, 2013, the Plan engaged an actuary to provide an independent estimate of its medical claims payable.

Reinsurance

Contractually, the Plan is reimbursed by AHCCCS at a rate ranging from 75% to 100% for qualified healthcare costs for those members that exceed stated amounts of up to $35,000, depending on the case type of the member. Qualified costs must be incurred during the contract year and are the lesser of the amount paid by the Plan or the AHCCCS fee schedule. Amounts are recognized under the contract with AHCCCS when healthcare costs exceed stated amounts as provided under the contract, including estimates of such costs at the end of each accounting period. In the event that AHCCCS is unable to honor its reinsurance commitment, the Plan may be responsible for excess costs incurred. Reinsurance recoveries totaling approximately $13,234,000 were recognized during the year ended September 30, 2013, and are included as a reduction of hospital medical expenses in the accompanying statement of earnings.

Administrative Expenses

The primary components of administrative expenses are management fees, premium taxes and amortization expense. Management fees are described further in Note 3.

Income Taxes

IASIS files consolidated federal and state income tax returns, which include the operating results of the Plan. IASIS allocates taxes to the Plan pursuant to the asset and liability method, as if the Plan were a separate taxpayer. For balance sheet purposes, such allocations are included in due from affiliates in the accompanying balance sheet.

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

AHCCCS receivables and payables, due from affiliates other current assets, accounts payable and accrued expenses and medical claims payable represent financial instruments. The carrying value of these financial instruments approximates their fair market value due to the short-term nature of these instruments.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates and are accounted for in the period identified.

Subsequent Events Consideration

The Plan evaluated events and transactions occurring subsequent to September 30, 2013 through January 24, 2014, the date these financial statements were available for issuance. During this period, there were no subsequent events that required recognition in the financial statements.

3. Transactions With Affiliates

The Plan is party to a management agreement with Health Choice Management Company (the Management Company), an indirect wholly owned subsidiary of IASIS, which manages the general and administrative functions related to the Plan inclusive of payroll, advertising and related expenses. During the year ended September 30, 2013, the Plan recorded expenses of approximately $36,640,000 for services provided by the Management Company, which are included in administrative expenses in the accompanying statement of earnings.

The Plan remitted fee-for-service payments totaling approximately $5,524,000 during the year ended September 30, 2013, to facilities which are owned and operated by IASIS.

4. AHCCCS Receivable

The AHCCCS receivable, net consists of the following at September 30, 2013:

Reinsurance, net	$ 4,206,915
Delivery supplement	704,986
Capitation receivable	1,371,123
PPC, TWG and prospective reconciliation settlements, net of risk adjustments	713,758
	$ 6,996,782

5. Leases

As a result of the Plan's management agreement with the Management Company, the Management Company assumed the remaining facility and equipment leases. The related rent expenses are included within the management fee charged by the Management Company, which is included in administrative expenses in the accompanying statement of earnings.

6. Commitments and Contingencies

Professional, General and Other Liability Insurance

The Plan is subject to claims and lawsuits arising in the ordinary course of business, including, but not limited to, injuries arising from patient treatment and denials thereof.

The Plan's contract with AHCCCS requires the Plan to maintain professional liability insurance, comprehensive general insurance, and automobile liability insurance coverage of at least $1,000,000 for each occurrence. During the year ended September 30, 2013, the Plan was covered under IASIS' umbrella policy. IASIS, on behalf of the Plan, carries professional and general liability insurance in excess of self-insured retentions through an unrelated commercial insurance carrier in amounts that IASIS believes to be sufficient for the Plan, although some claims may exceed the scope of coverage in effect. IASIS maintains reserves for professional and general liability claims. Accordingly, no reserve for liability risks are recorded in the accompanying balance sheet. Professional and general liability insurance expense is included in

6. Commitments and Contingencies (continued)

the management fee charged by the Management Company for the year ended September 30, 2013, which is included in administrative expenses in the accompanying statement of earnings. The Plan is currently not a party to any such proceedings that, in the Plan's opinion, would have a material adverse effect on the Plan's business, financial condition or results of operations.

Performance Guarantee

If the Plan fails to effectively manage healthcare costs, these costs may exceed the premiums received by the Plan. The Plan believes the capitated premiums, together with reinsurance and other supplemental premiums, are sufficient to pay for the services the Plan is obligated to deliver. Pursuant to its contract with AHCCCS, the Plan is required annually to provide a performance bond or letter of credit, in an acceptable form, to guarantee performance of the Plan's obligations under its contract to provide and pay for the healthcare services. The amount of the performance guaranty that AHCCCS requires is generally based upon the membership in the Plan and the related capitation paid to the Plan. As of September 30, 2013, the Plan provided a performance guarantee in the form of an irrevocable standby letter of credit for the benefit of AHCCCS totaling approximately $39,890,000.

State and Federal Laws and Regulations

The Plan is subject to state and federal laws and regulations. The Centers for Medicare and Medicaid Services and AHCCCS have the right to audit the Plan to determine the Plan's compliance with such standards. The Plan is required to file periodic reports with AHCCCS and to meet certain financial viability standards. The Plan must also provide its enrollees with certain mandated benefits and must meet certain quality assurance and improvement requirements. The Plan believes it is in compliance with these AHCCCS requirements. The Plan must also comply with the electronic transactions regulations and privacy standards of the Health Insurance Portability and Accountability Act (HIPAA). The Plan believes it is in compliance with the HIPAA security standards as set forth in 45 CFR Part 164. The Plan has also complied with the requirements for health plans defined in 45 CFR Part 162.