



Maricopa Health Plan (A Contract of Maricopa Integrated Health System)

Financial Statements
With Independent Auditor's Report Thereon
June 30, 2013 and 2012

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Independent Auditor's Report

To the Board of Directors
Maricopa Health Plan (a contract of Maricopa Integrated Health System)
Phoenix, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of Maricopa Health Plan (MHP or the Plan) (a contract of Maricopa Integrated Health System), which comprise the statements of net position as of June 30, 2013 and 2012, its related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Maricopa Health Plan (a contract of Maricopa Integrated Health System) as of June 30, 2013 and 2012, and its changes in net position 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, MHP is a contract of Maricopa County Special Health Care District, d/b/a Maricopa Integrated Health System (MIHS), a statutory Special Health Care District and political subdivision of the State of Arizona. The financial statements present only MHP and do not purport to, and do not, present fairly the financial position of MIHS and its changes in net position and its cash flows in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information is presented for additional analysis and is not a required part of the basic 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 audits 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 of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Management has omitted a management's discussion and analysis for MHP 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 content. Our opinions on the basic financial statements are not affected by this missing information.

McGladrey LLP

Minneapolis, Minnesota
October 23, 2013

**Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)**

**Statements of Net Position
June 30, 2013 and 2012**

Assets	2013	2012
Current Assets		
Cash and cash equivalents	\$ 24,493,302	\$ 26,331,335
Reinsurance receivable	3,318,398	3,404,042
Capitation and supplemental revenue receivable	98,680	64,228
Reconciliation receivable	3,992,882	-
Other current assets	562,365	981,174
Total current assets	32,465,627	30,780,779
Reconciliation Receivable	1,903,440	2,390,306
Other Assets	-	153,219
	\$ 34,369,067	\$ 33,324,304
 Liabilities and Net Position		
Current Liabilities		
Accounts payable	\$ 501	\$ 8,271
Accrued administrative costs	1,213,754	1,279,329
Medical claims payable	13,444,990	15,139,044
Reconciliation payable	284,149	420,088
Other current liabilities	219,604	432,612
Total liabilities	15,162,998	17,279,344
 Commitments and Contingencies		
Unrestricted Net Position	19,206,069	16,044,960
	\$ 34,369,067	\$ 33,324,304

See Notes to Financial Statements.

Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)

Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2013 and 2012

	2013	2012
Revenues and gains, net:		
Capitation	\$ 126,037,580	\$ 148,551,200
PPC capitation	4,233,952	6,715,893
Prospective tiered settlement	(284,149)	-
Delivery supplement	8,010,709	8,774,252
TWG reconciliation settlement	2,278,078	347,044
PPC reconciliation settlement	990,517	(377,181)
Investment income	118,227	193,515
Premium deficiency reserve and other	382,000	(382,000)
Total revenues and gains, net	141,766,914	163,822,723
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	29,569,963	40,756,235
PPC—hospital inpatient	3,158,943	2,799,614
Total hospitalization expenses	32,728,906	43,555,849
Medical compensation:		
Primary care physician services	7,574,557	8,474,192
Referral physician services	16,249,769	22,190,708
Other professional services	4,862,407	5,524,055
PPC—physician services	722,290	745,896
Total medical compensation expenses	29,409,023	36,934,851
Other medical expenses:		
Emergency services	13,116,866	15,504,181
Pharmacy	15,294,451	17,948,951
Lab, X-ray and medical imaging	4,786,851	3,650,058
Outpatient facility	15,588,852	16,884,558
Durable medical equipment	1,160,027	1,823,229
Dental	6,571,821	7,546,720
Transportation	4,725,349	5,358,077
Nursing facility, home health care	2,657,781	3,197,923
Physical therapy	(88,202)	28,105
PPC—other	1,231,544	1,211,028
Total other medical expenses	65,045,340	73,152,830
Total health care expenses	127,183,269	153,643,530
Less:		
Reinsurance recoveries	5,100,149	9,439,060
Third-party liability	2,439,411	541,054
Total net health care expenses	119,643,709	143,663,416

(Continued)

**Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)**

**Statements of Revenues, Expenses and Changes in Net Position (Continued)
Years Ended June 30, 2013 and 2012**

	2013	2012
Administrative expenses:		
Management fees	15,493,064	16,192,714
Other	601,350	248,064
Total administrative expenses	16,094,414	16,440,778
Premium taxes	2,867,682	3,610,515
Total operating expenses	138,605,805	163,714,709
Operating gain	3,161,109	108,014
Unrestricted net position, beginning	16,044,960	15,936,946
Unrestricted net position, ending	\$ 19,206,069	\$ 16,044,960

See Notes to Financial Statements.

Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)

Statements of Cash Flows
Years Ended June 30, 2013 and 2012

	2013	2012
Cash Flows From Operating Activities		
Cash received for capitation and supplemental revenue receipts	\$ 145,565,730	\$ 174,962,559
Cash paid to providers and facilities	(128,877,323)	(163,115,563)
Cash paid for supplies, purchased services and other	(18,526,440)	(20,999,205)
Net cash used in operating activities	(1,838,033)	(9,152,209)
Net decrease in cash and cash equivalents	(1,838,033)	(9,152,209)
Cash and Cash Equivalents, beginning	26,331,335	35,483,544
Cash and Cash Equivalents, ending	\$ 24,493,302	\$ 26,331,335
Reconciliation of Operating Gain to Net Cash Used in Operating Activities		
Operating gain	\$ 3,161,109	\$ 108,014
Adjustments to reconcile operating gain to net cash used in operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	85,644	3,997,197
Capitation and supplemental revenue receivable	(34,452)	6,031
Other current assets	418,809	(17,620)
Reconciliation receivable	(3,506,016)	(1,215,223)
Other assets	153,219	122,575
Accounts payable	(73,345)	(266,616)
Medical claims payable	(1,694,054)	(9,472,033)
Reconciliation payable	(135,939)	(2,772,271)
Other current liabilities	(213,008)	357,737
Total adjustments	(4,999,142)	(9,260,223)
Net cash used in operating activities	\$ (1,838,033)	\$ (9,152,209)

See Notes to Financial Statements.

**Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)**

Notes to Financial Statements

Note 1. Organization and Operations

Organizational structure: Maricopa Health Plan (MHP or the Plan) provides health plan services to enrollees under a contract with the Arizona Health Care Cost Containment System (AHCCCS) in Maricopa County, Arizona. Effective October 1, 2005, Maricopa County Special Health Care District, d/b/a Maricopa Integrated Health System (MIHS), a statutory Special Health Care District and political subdivision of the State of Arizona, assumed the operations and financial responsibility for MHP, which was previously operated by Maricopa County. The Plan is governed by MIHS. MHP has a contract with University Physicians Healthcare (UPH) to provide comprehensive management and administrative services necessary for the operation of the Plan. The financial statements present only MHP and do not purport to, and do not, present fairly the net position of MIHS and its changes in net position and its cash flows in conformity with accounting principles generally accepted in the United States of America.

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

Note 2. Summary of Significant Accounting Policies

Basis of accounting: The Plan 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. The Plan follows applicable Governmental Accounting Standards Board (GASB) principles and has prepared the Plan'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: Cash and cash equivalents consist of cash and investments held by the Maricopa County Treasurer. Deposits with the County Treasurer are available on demand and are pooled with other County monies for investment. The County Treasurer considers all of the Plan's investments to be cash equivalents, which are represented by investments in the County's cash management pool with maturities of three months or less from the date of purchase. The carrying amount approximates fair value because of the highly liquid nature of those instruments. The Plan's pro rata share of the cash management pool is not identified with specific investments. MHP earns interest income on its deposits included in the Maricopa County Treasurer's Pooled Investments fund.

Cash is advanced to MHP as needed to fund expenditures. Advances are deposited with various financial institutions. At times, such deposits may be in excess of the FDIC insurance limit; however, to date, MHP has not experienced any losses on such accounts.

**Maricopa Health Plan
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Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Reinsurance receivable: Reinsurance receivable represents management's best estimate and is calculated based on the identification of qualifying incurred inpatient expenses and a percentage of estimated inpatient and certain pharmaceutical costs incurred but not yet reported. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. MHP recorded reduced reinsurance recoveries of approximately \$380,000 during 2013 that relates to services provided in 2012, and an increase of approximately \$900,000 during 2012 that relates to services provided in 2011.

Medical claims payable: The costs of hospital and medical services provided to enrollees served under contract are accrued 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 reported 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 at least a possibility that recorded estimates will change by a material amount in the near term. Management believes that the medical claims payable is adequate. See also Note 3.

Premium deficiency reserve: MHP 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 accrued. Investment income is not included in the calculation of premium deficiency reserves. At June 30, 2013, contracted rates and anticipated expenses did not warrant a premium deficiency reserve. At June 30, 2012, MHP recorded a premium deficiency reserve of \$382,000, which is included in other current liabilities.

Unrestricted net position: Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted in accordance with GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and Statement No. 38, *Certain Financial Statement Note Disclosures*.

Investment income: MHP earns interest income on its deposits included in the Maricopa County Treasurer's Pooled Investments fund. MHP's investment income consists of interest of approximately \$118,000 and \$194,000 for 2013 and 2012, respectively.

Capitation revenues: Capitation revenues include premiums earned under contracts that require MHP to provide health care services to subscribers of AHCCCS for monthly capitation fees as agreed upon by MHP 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 at least 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 MHP during a prospective enrollment period. This supplemental payment does not include payment for deliveries of those members who deliver in a prior coverage period.

**Maricopa Health Plan
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Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Reconciliation settlement revenue (expense): Amounts due to (from) the State of Arizona for prior-period coverage (PPC) reconciliation settlement revenue (expense) represents MHP's profit or loss in excess of 2 percent of capitation received for the population and is estimated based on the state's applicable policy. Because the reconciliation settlement is subject to change based on claims experience, there is at least 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 MHP's profit or loss for these members in excess of 3 percent for the population. For the contract year ended September 30, 2013, the TWG reconciliation settlement represents MHP'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 at least a possibility that recorded reconciliation settlements will change by a material amount in the near term.

Amounts due to (from) the State of Arizona for the Prospective Tiered reconciliation settlement represents MHP's profit or loss for the prospective non-TWG members. For the contract year ended September 30, 2013, this reconciliation settlement represents MHP's profit 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 at least 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 the management fee paid to UPH (see Note 5) for the management of the Plan.

Premium tax: The State of Arizona imposes a premium tax on capitation payments paid to the Plan by AHCCCS. The Plan receives the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. The Plan 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: As a governmental unit or a political subdivision thereof, MIHS is exempt from federal income tax under Section 115(1) of the Internal Revenue Code. MIHS is also exempt from state income taxes. Accordingly, no provision is made for income taxes in the accompanying financial statements.

Risk management: The Plan is exposed to various risks of loss from torts, business interruption, errors and omissions, and natural disasters. Commercial insurance coverage is purchased by the District for MHP for claims arising from such matters.

The Plan 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 \$20,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid by the State at 75 percent to 85 percent 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.

**Maricopa Health Plan
(A Contract of Maricopa Integrated Health System)**

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Subsequent events: All of the effects of subsequent events that provide additional evidence about conditions that existed at the financial statement date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. The Plan 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.

The Plan has evaluated events and transactions occurring subsequent to June 30, 2013, through October 23, 2013, the date of issuance of the financial statements. During this period, there were no events requiring recognition in the financial statements. Additionally, there were no nonrecognized subsequent events requiring disclosure.

Adoption of accounting pronouncement: During the year ended June 30, 2013, MHP implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement is intended to improve financial reporting by providing citizens and other users of state and local government financial reports with information about how past transactions will continue to affect a government's financial statements in the future. This statement provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). The statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. This statement also amends certain provisions of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets. As MHP does not have deferred inflows or outflows falling within the scope of this statement, the only effect of its implementation was to change the terminology within the financial statements from net assets to net position.

Note 3. Medical Claims Payable

Medical claims liability consists of the following at June 30, 2013 and 2012:

	June 30	
	2013	2012
Claims payable or pending approval	\$ 5,046,393	\$ 7,945,239
Provisions for claims incurred but not yet reported	8,398,597	7,193,805
	<u>\$ 13,444,990</u>	<u>\$ 15,139,044</u>

The cost of health care services is recognized in the period in which care is provided and includes an estimate of the cost of services that has been incurred but not yet reported. The Plan 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.

**Maricopa Health Plan
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Notes to Financial Statements

Note 3. Medical Claims Payable (Continued)

The following is a reconciliation of the accrued claims liability for the years ended June 30, 2013 and 2012:

	2013	2012
Beginning balance	\$ 15,139,044	\$ 24,611,077
Incurred:		
Current	126,979,237	155,096,498
Prior	204,032	(1,452,968)
Total	<u>127,183,269</u>	<u>153,643,530</u>
Paid:		
Current	113,534,247	140,052,069
Prior	15,343,076	23,063,494
Total	<u>128,877,323</u>	<u>163,115,563</u>
Ending balance	<u>\$ 13,444,990</u>	<u>\$ 15,139,044</u>

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

MHP purchased hospitalization and medical compensation services from MIHS. During 2013 and 2012, MHP paid claims to MIHS totaling approximately \$20,000,000 and \$23,000,000, respectively.

Note 5. Commitments and Contingencies

Litigation: The Plan 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 the Plan's financial position or results of operations.

AHCCCS performance measures: MHP's contract with AHCCCS requires the Plan to be in compliance with certain financial and quality performance measures as defined. During fiscal year 2013, for the contract year ended September 30, 2011, management has determined that MHP did not meet certain quality AHCCCS performance measures. In response to these violations, AHCCCS may require MHP to submit corrective action plans and subject MHP to sanctions of an estimated \$150,000. At June 30, 2013, MHP has recognized \$150,000 related to this potential liability. Due to the uncertainty of the outcome of AHCCCS' review, it is at least reasonably possible that recorded estimates will change by a material amount in the near term.

**Maricopa Health Plan
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Notes to Financial Statements

Note 5. Commitments and Contingencies (Continued)

During fiscal year 2013, MHP was out of compliance with their administrative expense ratio as defined by AHCCCS. MHP's fiscal year administrative ratio was 11 percent compared to the AHCCCS-defined compliance standard of less than 10 percent. The management contract between UPH and MIHS will be amended to calculate the management fee as a percent of revenue effective October 1, 2013. The change will ensure MHP's compliance with the administrative expense ratio for fiscal year 2014. AHCCCS approved the action plan, with no further action to be taken, and no additional penalties were assessed related to this fiscal year 2013 instance of contractual noncompliance.

Performance bond: MIHS has secured an irrevocable letter of credit in the amount of \$10,000,000 with an independent party to fulfill the performance bond requirement of the AHCCCS contract. The irrevocable letter of credit expires on September 30, 2014.

Contract with UPH: MHP has a management agreement with UPH through September 30, 2014, that provides for payments to UPH based on a fixed per member, per month rate (as defined) as consideration for services rendered. Management fees to UPH are classified under administrative expenses in the statement of revenues, expenses and changes in net position.

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 MHP 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.