

FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Banner University Family Care  
Years Ended December 31, 2019 and 2018  
With Reports of Independent Auditors

Ernst & Young LLP



Banner University Family Care  
Financial Statements and Supplementary Information  
Years Ended December 31, 2019 and 2018

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## Report of Independent Auditors

The Board of Directors  
Banner University Family Care

We have audited the accompanying financial statements of Banner University Family Care which comprise the balance sheets as of December 31, 2019 and 2018, 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 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 audits. We conducted our audits 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.



## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Banner University Family Care at December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst + Young LLP*

April 30, 2020

# Banner University Family Care

## Balance Sheets

	<b>December 31</b>	
	<b>2019</b>	<b>2018</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 332,805,876	\$ 261,931,962
Reinsurance receivable	23,549,727	11,517,980
Capitation and supplemental revenues receivable	933,001	494,314
Reconciliation receivable	21,941,625	6,297,251
Other current assets	7,256,904	5,798,668
Total current assets	<u>386,487,133</u>	286,040,175
Reconciliation receivable	32,474,926	23,630,787
Other assets	163,749	738,756
Total assets	<u><u>\$ 419,125,808</u></u>	<u><u>\$ 310,409,718</u></u>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 15,483,811	\$ 5,148,136
Due to affiliate	151,883,822	85,710,932
Medical claims payable	167,251,471	135,991,931
Reconciliation payable	–	6,560,306
Alternative payment model	25,740,436	6,017,236
Other current liabilities	2,275,635	3,635,182
Total current liabilities	<u>362,635,175</u>	243,063,723
Reconciliation and alternative payment model payable	491,440	10,240,040
Total liabilities	<u>363,126,615</u>	253,303,763
Commitments and contingencies		
Net assets	55,999,193	57,105,955
Total liabilities and net assets	<u><u>\$ 419,125,808</u></u>	<u><u>\$ 310,409,718</u></u>

*See accompanying notes.*

## Banner University Family Care

### Statements of Revenues, Expenses, and Changes in Net Assets

	<b>Year Ended December 31</b>	
	<b>2019</b>	<b>2018</b>
<b>Revenue</b>		
Capitation premiums	\$ 1,139,237,190	\$ 774,762,450
Delivery premiums	26,086,022	17,091,495
Reconciliation settlement, net	32,218,515	22,010,153
Alternative payment model	6,566,929	16,926,518
Investment income, net	5,720,034	3,430,600
Total revenues	<b>1,209,828,690</b>	834,221,216
<b>Health care expenses</b>		
Hospitalization	190,123,063	117,047,531
Medical compensation	294,561,250	166,257,026
Ancillary and other medical services	462,449,705	302,927,689
Institutional	134,961,015	123,660,078
Home and community-based services	86,201,399	98,178,010
Case management services	12,030,985	11,656,589
Less reinsurance recoveries	(50,400,100)	(34,162,211)
Total health care expenses	<b>1,129,927,317</b>	785,564,712
General and administrative expenses	59,366,033	43,131,332
Premium tax expense	24,331,594	16,719,621
Total operating expenses	<b>1,213,624,944</b>	845,415,665
Operating loss	(3,796,254)	(11,194,449)
Community reinvestment expense	110,508	-
Net loss	<b>(3,906,762)</b>	(11,194,449)
Net assets, beginning of period	57,105,955	45,700,404
Contribution from affiliate	2,800,000	22,600,000
Net assets, end of period	<b>\$ 55,999,193</b>	<b>\$ 57,105,955</b>

*See accompanying notes.*

# Banner University Family Care

## Statements of Cash Flows

	<b>Year Ended December 31</b>	
	<b>2019</b>	<b>2018</b>
<b>Operating activities</b>		
Net loss	\$ (3,906,762)	\$ (11,194,449)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	(12,031,747)	(5,979,543)
Capitation and supplemental revenues receivable	(438,687)	9,557,185
Reconciliation receivable	(24,488,513)	(24,895,523)
Other current assets	(1,458,236)	(3,936,624)
Accounts payable and other liabilities	8,976,128	(570,885)
Medical claims payable	31,259,540	54,111,760
Reconciliation and alternative payment model payable	3,414,294	(5,920,570)
Due to affiliates	68,972,890	52,502,288
Net cash provided by operating activities	<u>70,298,907</u>	<u>63,673,639</u>
<b>Investing activities</b>		
Decrease in other assets	575,007	5,733,176
Net cash provided by investing activities	<u>575,007</u>	<u>5,733,176</u>
Net increase in cash and cash equivalents	70,873,914	69,406,815
Cash and cash equivalents at beginning of period	261,931,962	192,525,147
Cash and cash equivalents at end of period	<u>\$ 332,805,876</u>	<u>\$ 261,931,962</u>

*See accompanying notes.*

# Banner University Family Care

## Notes to Financial Statements

December 31, 2019

### 1. Organization and Operations

#### Organizational Structure

Banner University Family Care (BUFC 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. Banner Health (Banner) is the sole corporate member of BUFC.

All of the Plan's revenues, except for investment income, were earned under its AHCCCS contracts, which are subject to periodic renewal. The BUFC financial statements include the financial activity associated with the following AHCCCS contracts:

- In March 2013, BUFC was awarded a new five-year Acute-Care (Acute-Care) Contract with AHCCCS through September 30, 2018.
- In March 2018, BUFC was awarded an AHCCCS Complete Care Contract (ACC) effective October 1, 2018 through September 30, 2025. The ACC contract includes the existing membership and geographic service areas of the Acute-Care contract, which ended September 30, 2018, and increased membership in additional geographic service areas. The ACC contract provides additional member service coverage beyond those services covered under the Acute-Care contract to include behavioral health services, physical health services, and coverage for children's rehabilitation services. The ACC contract includes a risk reconciliation whereby BUFC and AHCCCS share in the contract gains and losses (see Note 3).
- On October 1, 2017 BUFC began operations for the AHCCCS Arizona Long Term Care System (ALTCS) contract, which is a seven-year contract awarded in March 2017. For the 2017 contract year ended September 30, 2018, the ALTCS contract incurred a loss of approximately \$28,000,000 as the premium revenues received were not sufficient to cover claim costs. A contract amendment was entered into in September 2018, retroactive to October 1, 2017, which provides for a risk reconciliation whereby BUFC and AHCCCS share in the contract gains and losses in excess of 7% of capitation revenues as defined in the contract. A contract amendment was also entered into in September 2018 relating to the contract period from October 1, 2018 through September 30, 2019. The contract also included a risk reconciliation whereby BUFC and AHCCCS share in the contract gains and losses as defined in the contract amendment, ranging from 2% to 7% of capitation revenues. Reconciliation revenue of approximately \$32,218,515 has been recorded on the



# Banner University Family Care

## Notes to Financial Statements (continued)

### 1. Organization and Operations (continued)

statement of revenues, expenses, and changes in net assets for the year ended December 31, 2019, relating to these contract amendments.

Continuation of the AHCCCS programs is dependent upon governmental policies. The loss of these contracts would have an adverse effect on BUFC's future operations.

### 2. Liquidity

Financial assets available for general expenditure within one year of the balance sheet date consist of the following as of December 31:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 332,805,876	\$ 261,931,962
Reinsurance receivable	23,549,727	11,517,980
Capitation and supplemental revenues receivable	933,001	494,314
Pharmacy rebate and due from vendors	6,421,463	5,033,491
	<u>\$ 363,710,067</u>	<u>\$ 278,977,747</u>

BUFC also has a net reconciliation receivable of \$54,416,551 as of December 31, 2019, which is subject to settlement with AHCCCS. The reconciliation receivable is settled with AHCCCS at the end of the contract year and once claim payment activity has been completed. Historically, AHCCCS has finalized the reconciliation receivable approximately two to three years subsequent to the contract year.

### 3. Summary of Significant Accounting Policies

#### Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Banner University Family Care

### Notes to Financial Statements (continued)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **Fair Value of Financial Instruments**

The carrying amounts of 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 Equivalents**

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

At December 31, 2019 and 2018, cash and cash equivalents include a money market account of \$78,717,873 and \$77,189,243, 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 contract with AHCCCS 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. BUFC recorded reinsurance receivable of \$23,549,727 as of December 31, 2019, of which \$13,192,893 is related to the 2019-2020 contract year and \$10,356,935 is related to the 2018-2019 contract year. There is a possibility that recorded estimates will change by a material amount in the near term.

##### **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, 2019 and 2018. 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 (see Note 5).

## Banner University Family Care

### Notes to Financial Statements (continued)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **Premium Deficiency Reserves**

BUFC 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. BUFC recorded a premium deficiency reserve of approximately \$1,550,000 at December 31, 2018, which was released and recorded as a decrease to administrative expense in the year ended December 31, 2019. No premium deficiency reserve was recorded as of December 31, 2019.

##### **Revenue**

BUFC adopted Accounting Standard Updates No. (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)* 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 ASU 2014-09, if any, as a cumulative effect adjustment to the beginning net assets recorded as of the date of adoption. BUFC has determined that there was no transition adjustment to record on January 1, 2018.

BUFC records revenue from AHCCCS in the form of capitation premium, delivery supplemental premium, reconciliation settlement, and reinsurance recoveries, which are recorded as a reduction to health care expenditures. Revenue is recorded at the estimated transaction price based on the terms outlined in the ACC and ALTCS contracts. BUFC evaluates whether an implicit price concession should be included in the estimate of the transaction price based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to revenue in the period of the change. Revenue is recognized as performance obligations are satisfied, which primarily relate to the monthly period in which health care coverage is provided to the enrollees.

##### *Capitation Premiums*

Capitation premiums include amounts earned under contracts that require BUFC to provide health care coverage to enrollees of AHCCCS. The monthly capitation revenues have been agreed upon by BUFC and AHCCCS. Capitation premiums are recognized as revenue in the period to which health care coverage relates.

## Banner University Family Care

### Notes to Financial Statements (continued)

#### **3. Summary of Significant Accounting Policies (continued)**

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

Amounts receivable under these contracts are recorded as capitation and supplemental revenues receivable. Capitation rates are subject to adjustment based on national episodic/diagnostic risk. There is a possibility that recorded amounts will change by a material amount in the near term. There are no amounts accrued for risk adjustment as of December 31, 2019.

#### *Delivery Supplemental Premiums*

Delivery supplemental premiums are recognized upon the delivery of a child by a member assigned to BUFC 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 BUFC and based on a formula defined by the AHCCCS contracts (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 BUFC through the September 30, 2016, contract period. Management has recorded a decrease to revenue of approximately \$1,500,000 and \$4,790,000 for the years ended December 31, 2019 and 2018, respectively, relating to the settlement of prior reconciliation contract years. The estimated reconciliation receivable (payable) for the open reconciliation contract years has been recorded as estimated reconciliation receivable (payable) on the accompanying balance sheets.

As part of the ACC contract that ended September 30, 2018 and 2019, amounts due to (from) AHCCCS for PPC reconciliation settlement represent BUFC's profit or loss in excess of 2% of capitation revenue for the PPC members as defined in AHCCCS's policy. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that the recorded reconciliation settlement will change by a material amount in the near term.

## Banner University Family Care

### Notes to Financial Statements (continued)

#### **3. Summary of Significant Accounting Policies (continued)**

As part of the ACC contract that ended September 30, 2018, amounts due to (from) AHCCCS for the Prospective Tiered reconciliation settlement represent BUFC's profit or loss for the prospective members. This reconciliation settlement represents 50% of BUFC's profit in excess of 3% to 6% of capitation revenue, 100% of BUFC's profit in excess of 6% of capitation revenue, and 100% of BUFC's loss in excess of 3% of capitation revenue. Because the reconciliation settlement is subject to change based on claims experience, there is a possibility that the recorded reconciliation settlement will change by a material amount in the near term.

As part of the ACC contract that ended September 30, 2017, and prior, amounts due to (from) AHCCCS for the Adults > 106% of the Federal Poverty Level, Adults > 106, formerly known as Newly Eligible Adults (NEAD), reconciliation settlement represent BUFC profit or loss for these members. The Adults > 106 reconciliation settlement represents BUFC's profit or loss for these members in excess of 1% of capitation revenue. Because the Adults > 106 reconciliation settlement is subject to change based on claims experience, there is a possibility that the recorded reconciliation settlement will change by a material amount in the near term. The policy pertaining to the NEAD reconciliation was closed as of September 30, 2017, and starting October 1, 2017, the NEAD population reconciliation is included in the PPC and Prospective Tiered as applicable.

As part of the ACC contract that was entered into on October 1, 2018, amounts due to (from) AHCCCS for the reconciliation settlement represent BUFC's profit or loss for all members enrolled in the ACC plan. This reconciliation settlement represents 50% of BUFC's profit in excess of 2% to 6% of capitation revenue, 100% of BUFC's profit in excess of 6% of capitation revenue, and 100% of BUFC's loss in excess of 2% capitation revenue. 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.

#### **Alternative Payment Model**

AHCCCS has developed an alternative payment model 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. BUFC is required to participate in these payment reform efforts as delineated by AHCCCS. As of December 31, 2019, and 2018, BUFC has a payable to AHCCCS related to this policy of approximately \$20,590,000 and \$13,705,000, respectively, which is primarily included in reconciliation and alternative payment model payable on the accompanying balance sheets. In 2019, AHCCCS closed and finalized the alternative payment model for contract year 2017. BUFC recorded approximately \$6,245,000 as an increase to revenue associated with the finalization of these contract years.

# Banner University Family Care

## Notes to Financial Statements (continued)

### **3. Summary of Significant Accounting Policies (continued)**

#### **General and Administrative Expenses**

General and 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 (see Note 7). These expenses are repaid by BUFC through intercompany settlements to Banner. These settlements are reflected as due to affiliate on the accompanying balance sheets.

#### **Premium Tax Expense**

The state of Arizona imposes a premium tax on capitation payments paid to BUFC by AHCCCS. BUFC receives the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. BUFC includes the taxes collected as capitation revenues and taxes remitted as a premium tax expense on the accompanying statements of revenues, expenses, and changes in net assets.

#### **Risk Management**

BUFC 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.

BUFC 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 and ACC Contracts 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.

## Banner University Family Care

### Notes to Financial Statements (continued)

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

##### Subsequent Events

BUFC has evaluated events and transactions occurring subsequent to December 31, 2019 through April 30, 2020, the date of issuance of the accompanying financial statements. In March 2020 the World Health Organization declared the global novel coronavirus disease 2019 (COVID-19) outbreak a pandemic. The Company has developed several emergency response and infectious disease practices and policies to the extent any of the business is impacted by COVID-19. As of April 30, 2020, the Company's operations have not been significantly impacted by the COVID-19 outbreak. The Company's operations may be adversely affected in the near term as a result of COVID-19, but the impact is not known at this point as the scale and severity of the outbreak is still unknown.

#### 4. Other Current Assets

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

	<u>2019</u>	<u>2018</u>
Pharmacy rebate receivable	\$ 1,735,281	\$ 1,221,950
Due from vendors	4,682,872	3,811,541
Prepaid expenses and other	838,751	765,177
	<u>\$ 7,256,904</u>	<u>\$ 5,798,668</u>

BUFC estimates the amount that will be received in pharmacy rebates based on contractual arrangements with the drug manufacturers. Changes to the pharmacy rebate contracts and membership growth have resulted in an increase to the pharmacy rebate receivable in 2019.

Overpayments to health care providers are reported as due from vendors. The provider is required to reimburse the Plan for the overpayment or have future claims offset the overpayment. Due from vendors increased in 2019 due to increased membership and increased claims activity in the ALTCS population.

## Banner University Family Care

### Notes to Financial Statements (continued)

#### 5. Medical Claims Payable

Medical claims payable consists of the following at December 31:

	<b>2019</b>	<b>2018</b>
Claims payable or pending approval	<b>\$ 116,006,429</b>	\$ 73,626,553
Provisions for claims incurred but not yet reported	<b>51,245,042</b>	62,365,378
	<b>\$ 167,251,471</b>	<b>\$ 135,991,931</b>

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. BUFC 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 on 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 number 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 years ended December 31:

	<b>2019</b>	<b>2018</b>
Beginning balance	<b>\$ 135,991,931</b>	\$ 81,880,171
Incurred:		
Current	<b>1,167,723,476</b>	812,235,013
Prior	<b>(617,903)</b>	7,491,910
Total	<b>1,167,105,573</b>	819,726,923
Paid:		
Current	<b>1,000,472,005</b>	676,243,082
Prior	<b>135,374,028</b>	89,372,081
Total	<b>1,135,846,033</b>	765,615,163
Ending balance	<b>\$ 167,251,471</b>	<b>\$ 135,991,931</b>



## Banner University Family Care

### Notes to Financial Statements (continued)

#### **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 becomes 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. The negative amounts reported for incurred, related to prior years, results from credits recognized in the current year for prior fiscal year activity.

#### **6. Related-Party Transactions**

BUFC purchases physician and hospital-based health care services for its members from Banner. During the years ended December 31, 2019 and 2018, BUFC paid claims for medical expenses to Banner totaling \$177,888,324 and \$103,540,310, respectively.

BUFC purchases administrative services from Banner, which are recognized as administrative expenses on the accompanying statements of revenues, expenses and changes in net assets. For the years ended December 31, 2019 and 2018, BUFC incurred \$40,700,356 and \$23,400,000, respectively, of corporate and health plan allocations from Banner and affiliated entities for administrative services and program activities (see Note 7).

At December 31, 2019 and 2018, BUFC had a payable to Banner recorded as due to affiliate of \$151,883,822 and \$85,710,932, respectively.

#### **7. Functional Expense**

The following statement of functional expenses reports BUFC's operating expenses by natural classification for the years ended December 31, 2019 and 2018. BUFC operating expenditures include allocations of Banner corporate expenditures of \$402,075 and \$1,365,410 and Banner health plan expenditures of \$28,267,297 and \$22,035,000 for the years ended December 31, 2019 and 2018, respectively. The Banner health plan expenditures relate to costs to operate Banner's insurance programs, primarily relating to claims management costs. Banner allocates the health plan expenditures based on plan enrollment. The Banner corporate expenditure allocation primarily relates to general and administrative functions and is provided by Banner for each of its operating units, including BUFC. Banner corporate allocations primarily relate to salary and

## Banner University Family Care

### Notes to Financial Statements (continued)

#### 7. Functional Expense

benefit costs associated with information technology, patient financial services, accounting, human resources, and other overhead-type services (see Note 1).

	Year Ended December 31	
	2019	2018
Expenses:		
Salaries and benefits	\$ 18,563,897	\$ 20,947,685
Supplies	7,603,875	3,700,937
Professional fees	3,065,445	3,751,351
Medical claims costs	1,129,927,317	785,564,712
Depreciation	733,017	618,047
Interest expense	2,408,960	2,161,586
Corporate allocations	402,076	1,365,410
Other	26,588,763	10,586,316
Premium taxes	24,331,594	16,719,621
Total operating expenses	<u>\$ 1,213,624,944</u>	<u>\$ 845,415,665</u>

#### 8. Income Taxes

BUFC is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3).

BUFC has not recorded any expense or accrued for any related expense for any uncertain tax positions. BUFC's 2015 through 2018 tax years remain subject to examination for federal income tax purposes, whereas the 2014 through 2018 tax years remain subject to examination for state taxing jurisdictions in which BUFC operates.

#### 9. Commitments and Contingencies

##### Litigation

BUFC 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 BUFC's financial position or results of operations.

## Banner University Family Care

### Notes to Financial Statements (continued)

#### **9. Commitments and Contingencies (continued)**

##### **AHCCCS Performance Measures**

BUFC's contract with AHCCCS requires BUFC to be in compliance with certain financial and nonfinancial performance measures, as well as certain prerequisites to maintain BUFC's eligibility as a party to the contract with AHCCCS. For the contract years ended September 30, 2012 through 2015, management determined that BUFC did not meet certain AHCCCS nonfinancial performance measures. In response to these violations, AHCCCS may require BUFC to submit a corrective action plan to cure the violations and may subject BUFC to sanctions. At December 31, 2019, BUFC had not accrued any amounts related to this potential liability. Due to the uncertainty of the outcome of AHCCCS's review, it is reasonably possible that recorded estimates will change by a material amount in the near term. Management believes that BUFC is in compliance with these nonfinancial performance measures for contract periods ended after September 30, 2016 and through December 31, 2019. 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 2019 and 2018, Banner and affiliated entities provided capital contributions of \$2,800,000 and \$22,600,000, respectively, which resulted in BUFC being in compliance with the required equity per member AHCCCS ratio. As of December 31, 2019, BUFC's equity per member was in compliance with the AHCCCS requirement.

##### **Performance Bond**

BUFC secured annual performance bonds in the amounts of \$27 million and \$80 million with an unrelated third-party insurance company to satisfy the performance bond requirement of BUFC's AHCCCS contracts. The bonds satisfy BUFC's contractual obligation as prescribed by AHCCCS. The current performance bonds expire September 30, 2020.

##### **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

Banner University Family Care  
Notes to Financial Statements (continued)

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

expulsion from government health care programs together with the imposition of significant fines and penalties. Management believes that BUFC 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



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## Report of Independent Auditors on Supplementary Information

The Board of Directors  
Banner University Family Care

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 (collectively the Acute-Care and ACC Contracts) and ALTCS Contracts, and the detail of sub-capitated expenses is presented for purposes of additional analysis and is 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, 2020

## Banner University Family Care

### Balance Sheet – ACC and ALTCS Contracts

December 31, 2019

	ACC	ALTCS	Total
<b>Assets</b>			
Current assets:			
Cash and cash equivalent	\$ 253,961,176	\$ 78,844,700	\$ 332,805,876
Reinsurance receivable	19,115,263	4,434,464	23,549,727
Capitation and supplemental revenues receivable	933,001	–	933,001
Reconciliation receivable	6,990,003	14,951,622	21,941,625
Other current assets	5,691,016	1,565,888	7,256,904
Total current assets	286,690,459	99,796,674	386,487,133
Reconciliation receivable	23,718,192	8,756,734	32,474,926
Other assets	–	163,749	163,749
Total assets	\$ 310,408,651	\$ 108,717,157	\$ 419,125,808
<b>Liabilities and net assets</b>			
Current liabilities:			
Accounts payable	\$ 13,363,279	\$ 2,120,532	\$ 15,483,811
Due to affiliate	116,590,611	35,293,211	151,883,822
Medical claims payable	116,497,392	50,754,079	167,251,471
Alternative payment model	19,273,251	6,467,185	25,740,436
Other current liabilities	1,979,873	295,762	2,275,635
Total current liabilities	267,704,406	94,930,769	362,635,175
Reconciliation and alternative payment model payable	491,440	–	491,440
Total liabilities	268,195,846	94,930,769	363,126,615
Net assets	42,212,805	13,786,388	55,999,193
Total liabilities and net assets	\$ 310,408,651	\$ 108,717,157	\$ 419,125,808

## Banner University Family Care

### Statement of Revenues and Expenses – ACC and ALTCS Contracts

Year Ended December 31, 2019

	<u>ACC</u>	<u>ALTCS</u>	<u>Total</u>
<b>Revenue</b>			
Capitation premiums	\$ 828,735,258	\$ 310,501,932	\$ 1,139,237,190
Delivery supplemental	26,086,022	–	26,086,022
Reconciliation settlement, net	22,341,243	9,877,272	32,218,515
Alternative payment model	6,566,929	–	6,566,929
Investment income, net	4,516,470	1,203,564	5,720,034
Total revenues	888,245,922	321,582,768	1,209,828,690
<b>Health care expenses</b>			
Hospitalization	182,497,519	7,625,544	190,123,063
Medical compensation	263,015,644	31,545,606	294,561,250
Ancillary and other medical services	425,424,605	37,025,100	462,449,705
Institutional	–	134,961,015	134,961,015
Home and community-based services	–	86,201,399	86,201,399
Case management services	–	12,030,985	12,030,985
Less reinsurance recoveries	(44,490,657)	(5,909,443)	(50,400,100)
Total health care expenses	826,447,111	303,480,206	1,129,927,317
General and administrative expenses	42,972,950	16,393,083	59,366,033
Premium tax expense	17,991,684	6,339,910	24,331,594
Total operating expenses	887,411,745	326,213,199	1,213,624,944
Operating income (loss)	834,177	(4,630,431)	(3,796,254)
Community reinvestment	110,508	–	110,508
Net income (loss)	<u>\$ 723,669</u>	<u>\$ (4,630,431)</u>	<u>\$ (3,906,762)</u>



## Banner University Family Care

### Statement of Cash Flows – ACC and ALTCS Contracts

Year Ended December 31, 2019

	ACC	ALTCS	Total
<b>Operating activities</b>			
Net income (loss)	\$ 723,669	\$ (4,630,431)	\$ (3,906,762)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Changes in assets and liabilities:			
Reinsurance receivable	(10,636,332)	(1,395,416)	(12,031,747)
Capitation and supplemental revenues receivable	(438,687)	–	(438,687)
Reconciliation receivable	(17,329,542)	(7,158,971)	(24,488,513)
Other current assets	(735,551)	(722,685)	(1,458,236)
Accounts payable and other liabilities	7,417,370	1,558,760	8,976,128
Medical claims payable	23,006,791	8,252,749	31,259,540
Reconciliation and alternative payment model payables	135,538	3,278,755	3,414,294
Due to affiliates	42,324,769	26,648,121	68,972,890
Net cash provided by operating activities	44,468,025	25,830,882	70,298,907
<b>Investing activities</b>			
Decrease in other assets	738,756	(163,749)	575,007
Net cash provided by (used in) investing activities	738,756	(163,749)	575,007
Net increase in cash and cash equivalent	45,206,781	25,667,133	70,873,914
Cash and cash equivalent at beginning of period	208,754,395	53,177,567	261,931,962
Cash and cash equivalent at end of period	\$ 253,961,176	\$ 78,844,700	\$ 332,805,876

## Banner University Family Care

### Detail of Sub-Capitated Expenses

	<b>Year Ended December 31</b>	
	<b>2019</b>	<b>2018</b>
Dental expenses	<b>\$ 27,945,229</b>	\$ 20,662,601
Primary care physician services	<b>1,033,847</b>	2,303,550
Total sub-capitated expenses	<b><u>\$ 28,979,076</u></b>	<u>\$ 22,966,151</u>

For the contract year from October 1, 2018 to September 30, 2019, dental expenses were \$27,005,932 and primary care physician services were \$1,470,812.

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