

**University Family Care Health  
Plan (a Contract of University  
Physicians Health Plans—  
University Family Care, LLC)**

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  
The University of Arizona Health Network  
Tucson, Arizona

### Report on the Financial Statements

We have audited the accompanying financial statements of University Family Care Health Plan (UFC) (a contract of University Physicians Health Plans—University Family Care, LLC, a component unit of The University of Arizona Health Network), as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statement, 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 University Family Care Health Plan (UFC) (a contract of University Physicians Health Plans—University Family Care, LLC, a component unit of The University of Arizona Health Network), as of June 30, 2013 and 2012, 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 contract of University Physicians Health Plans—University Family Care, LLC (UPHP-UFC, LLC) and was formerly operated as a 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 UPH or UPHP-UFC, LLC and their changes in net position and their cash flows in conformity with accounting principles generally accepted in the United States of America.

As described more fully in Note 5, UFC's contract with AHCCCS requires certain prerequisites to maintain eligibility as a party to the AHCCCS contract. Effective October 1, 2013, UFC will achieve compliance with certain of these prerequisites due to University Care Advantage, LLC (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 has not been renewed for calendar year 2014, and UFC will no longer be in compliance with this AHCCCS requirement as of January 1, 2014. This lack of compliance could result in sanctions, financial penalties, required corrective action plans, or termination of the AHCCCS contract.

**Other Matters**

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The supplemental information is presented for purposes of 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 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 content. Our opinions on the basic financial statements are not affected by this missing information.



Minneapolis, Minnesota  
October 23, 2013

**University Family Care Health Plan**  
**(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**Balance Sheets**  
**June 30, 2013 and 2012**

<b>Assets</b>	<b>2013</b>	<b>2012</b>
Current Assets		
Reinsurance receivable	\$ 8,258,388	\$ 6,499,466
Capitation and supplemental revenues receivable	138,697	140,955
Due from affiliate	42,374,434	42,511,185
Reconciliation receivable	543,106	482,081
Other current assets	876,177	1,132,563
<b>Total current assets</b>	<b>52,190,802</b>	<b>50,766,250</b>
Reconciliation Receivable	349,710	-
Other Assets	262,464	164,793
<b>Total</b>	<b>\$ 52,802,976</b>	<b>\$ 50,931,043</b>
 <b>Liabilities and Net Position</b>		
Current Liabilities		
Accounts payable	\$ 759,278	\$ 1,160,551
Medical claims payable	20,574,427	20,921,749
Reconciliation payable	2,599,660	1,672,573
Other current liabilities	749,542	131,756
<b>Total current liabilities</b>	<b>24,682,907</b>	<b>23,886,629</b>
Reconciliation Payable	157,805	1,950,018
<b>Total liabilities</b>	<b>24,840,712</b>	<b>25,836,647</b>
Commitments and Contingencies		
Unrestricted Net Position	27,962,264	25,094,396
<b>Total</b>	<b>\$ 52,802,976</b>	<b>\$ 50,931,043</b>

See Notes to Financial Statements.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

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

	2013	2012
Revenues, net:		
Capitation	\$ 178,688,967	\$ 206,792,775
PPC capitation	4,626,285	5,492,966
Delivery supplement	12,713,145	12,788,085
TWG reconciliation settlement	839,312	(3,493,926)
PPC reconciliation settlement	335,501	(1,220,092)
<b>Total revenues, net</b>	<b>197,203,210</b>	<b>220,359,808</b>
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	39,606,934	50,391,232
PPC—hospital inpatient	2,686,563	2,105,070
<b>Total hospitalization expenses</b>	<b>42,293,497</b>	<b>52,496,302</b>
Medical compensation:		
Primary care physician services	10,674,847	11,546,925
Referral physician services	24,498,470	30,924,237
Other professional services	6,554,467	6,614,022
PPC—physician services	701,892	499,564
<b>Total medical compensation expenses</b>	<b>42,429,676</b>	<b>49,584,748</b>
Other medical expenses:		
Emergency facility services	18,388,470	20,440,491
Pharmacy	34,695,555	35,377,077
Lab, X-ray and medical imaging	7,573,296	4,805,816
Outpatient facility	21,891,413	25,234,353
Durable medical equipment	1,941,849	1,802,841
Dental	7,611,465	8,961,514
Transportation	9,308,960	10,092,555
Nursing facility, home health care	2,295,428	2,515,990
Physical therapy	(12,982)	(58,764)
PPC—other	1,330,739	923,339
<b>Total other medical expenses</b>	<b>105,024,193</b>	<b>110,095,212</b>
<b>Total health care expenses</b>	<b>189,747,366</b>	<b>212,176,262</b>
Less:		
Reinsurance recoveries	13,893,284	17,545,452
Third-party liability	3,207,458	634,699
<b>Total net health care expenses</b>	<b>172,646,624</b>	<b>193,996,111</b>

(Continued)

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

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

	<b>2013</b>	<b>2012</b>
Administrative expenses:		
Compensation	9,568,406	9,676,510
Data processing	1,164,920	1,063,465
Management fees	2,075,721	1,802,126
Interest	14,487	27,801
Occupancy	113,403	165,178
Depreciation	579,868	441,998
Marketing	30,300	50,303
Other	3,951,585	3,932,159
<b>Total administrative expenses</b>	<b>17,498,690</b>	<b>17,159,540</b>
Premium taxes	4,190,028	4,922,394
<b>Total operating expenses</b>	<b>194,335,342</b>	<b>216,078,045</b>
<b>Operating gain</b>	<b>2,867,868</b>	<b>4,281,763</b>
Net position, beginning	25,094,396	20,812,633
Net position, ending	<u>\$ 27,962,264</u>	<u>\$ 25,094,396</u>

See Notes to Financial Statements.

**University Family Care Health Plan**  
**(A Contract of University Physicians Health Plans—University Family Care, LLC)**

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

	2013	2012
<b>Cash Flows From Operating Activities</b>		
Cash received for services provided and other operating activities	\$ 211,177,567	\$ 243,461,821
Cash paid to providers and facilities	(190,094,688)	(221,199,916)
Cash paid for supplies, purchased services and other	(21,219,630)	(22,198,374)
<b>Net cash provided by (used in) operating activities</b>	<b>(136,751)</b>	<b>63,531</b>
<b>Cash Flows From Investing Activities</b>		
Change in due from affiliate	136,751	(63,531)
<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>
<b>Reconciliation of Operating Gain to Net Cash Provided by (Used in) Operating Activities</b>		
Operating gain	\$ 2,867,868	\$ 4,281,763
Adjustments to reconcile operating gain to net cash provided by (used in) operating activities:		
Changes in assets and liabilities:		
Reinsurance receivable	(1,758,922)	1,417,601
Capitation and supplemental revenues receivable	2,258	27,902
Other current assets	256,386	442,045
Reconciliation receivable	(410,735)	1,101,015
Other assets	(97,671)	131,834
Accounts payable	(401,273)	(224,856)
Medical claims payable	(347,322)	(9,023,654)
Reconciliation payable	(865,126)	2,065,134
Other current liabilities	617,786	(155,253)
<b>Net cash provided by (used in) operating activities</b>	<b>\$ (136,751)</b>	<b>\$ 63,531</b>

See Notes to Financial Statements.



**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**Notes to Financial Statements**

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**Note 1. Organization and Operations**

**Organizational structure:** University Family Care Health Plan (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. Formerly operated by a division of University Physicians Healthcare (UPH), University Physicians Health Plans—University Family Care, LLC (UPHP-UFC, LLC) is a single-member Arizona limited liability company controlled by UPH. UPHP-UFC, LLC was formed to operate the Plan. The accompanying financial statements present the financial position and changes in net position of the Plan only and do not represent the financial position and changes in net position of UPH or UPHP-UFC, LLC.

All of UFC'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 the Plan 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.

In June 2010, The University of Arizona Health Network (the Corporation or UAHN) (formerly known as UA Healthcare, Inc.) was created to bring University Medical Center (UMC) and 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 members and granting the Corporation certain reserved power and authority. The Plan is governed by the Board of UPH.

**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:** 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 at least a possibility that recorded estimates will change by a material amount in the near term. UFC recorded additional reinsurance recoveries of approximately \$245,000 during 2013 and approximately \$2,300,000 during 2012 that represents an increase in amounts over the 2012 and 2011 estimates, respectively.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**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 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 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 at least a possibility that recorded estimates will change by a material amount in the near term. See also Note 3.

**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 accrued. 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, 2013 or 2012.

**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 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 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 (expense) represents UFC's profit or loss in excess of 2 percent 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 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 UFC's profit or loss for these members in excess of 3 percent for the population. For the contract year ending September 30, 2013, the TWG reconciliation settlement represents UFC's profit or loss for these members in excess of 2 percent 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.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**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 non-TWG members. For the contract year ending September 30, 2013, this tiered reconciliation settlement represents UFC'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 administrative expenses that directly relate to the AHCCCS program and an allocation for general and administrative expenses.

**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:** UFC is a single-member limited liability company and accordingly does not file its own tax return. All activity of UFC is reported on the tax returns of UPH. UPH is recognized as a tax-exempt organization for federal income tax purposes under Section 501(c)(3) of the Internal Revenue Code. UPH has also been recognized as a tax-exempt organization for state income tax purposes. Accordingly, no income taxes are provided in the accompanying financial statements.

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, 2009, for federal and June 30, 2008, 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.

**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.

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 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. 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.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**Notes to Financial Statements**

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**Note 2. Summary of Significant Accounting Policies (Continued)**

UFC 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, with the exception of the lack of a Medicare Advantage Special Needs Plan (Medicare SNP) contract renewal with the Centers for Medicare & Medicaid Services for calendar year 2014, as disclosed in Note 5.

**Adoption of accounting pronouncement:** During the year ended June 30, 2013, UFC 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 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 UFC 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 payable consists of the following at June 30, 2013 and 2012:

	2013	2012
Claims payable or pending approval	\$ 7,536,772	\$ 9,121,633
Provisions for claims incurred but not yet reported	13,037,655	11,800,116
	<u>\$ 20,574,427</u>	<u>\$ 20,921,749</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.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**Notes to Financial Statements**

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

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

	2013	2012
Beginning balance	\$ 20,921,749	\$ 29,945,403
Incurred:		
Current	189,238,442	215,756,370
Prior	508,924	(3,580,108)
Total	189,747,366	212,176,262
Paid:		
Current	168,664,015	194,869,621
Prior	21,430,673	26,330,295
Total	190,094,688	221,199,916
Ending balance	\$ 20,574,427	\$ 20,921,749

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 2013 and 2012, UFC paid claims for medical expenses to UPH and UMC totaling \$36,179,486 and \$39,645,795, 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, 2013 and 2012, UFC had a receivable totaling \$42,374,434 and \$42,511,185, respectively, due from UAHN.

**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.

**University Family Care Health Plan  
(A Contract of University Physicians Health Plans—University Family Care, LLC)**

**Notes to Financial Statements**

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**Note 5. Commitments and Contingencies (Continued)**

**AHCCCS performance measures:** UFC's contract with AHCCCS requires the Plan 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 will achieve compliance with certain of these prerequisites due to University Care Advantage, LLC (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 has not been renewed for calendar year 2014, and UFC will no longer be in compliance with this AHCCCS requirement as of January 1, 2014. This lack of compliance could result in sanctions, financial penalties, required corrective action plans, or termination of the AHCCCS contract. During fiscal year 2013, for the contract year ended September 30, 2011, management has determined that the Plan did not meet certain AHCCCS nonfinancial performance measures. In response to these violations, AHCCCS may require UFC to submit a corrective action plan to cure the violations and may subject the Plan to sanctions of an estimated \$200,000. At June 30, 2013, UFC has accrued \$200,000 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.

**Performance bond:** UPH secured an annual performance bond on behalf of UFC in the amount of \$15,500,000 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 December 31, 2013.

**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.