# Financial Statements and Schedules of Required Supplementary Information

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System
Years Ended June 30, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP

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Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Financial Statements and Schedules of
Required Supplementary Information

Years Ended June 30, 2017 and 2016

## Contents


Report of Independent Auditors....1

Management's Discussion and Analysis ....3

Financial Statements

Statements of Net Position....12
Statements of Revenues, Expenses, and Changes in Net Position ....14
Statements of Cash Flows....15
Notes to Financial Statements....17

Schedules of Required Supplementary Information

Schedule of District's Proportionate Share of the Net Pension Liability ....47
Schedule of Contributions....48

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*....49

Schedule of Findings....51

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# Report of Independent Auditors

The Management and the Board of Directors
Maricopa County Special Health Care District d/b/a Maricopa
Integrated Health System

We have audited the accompanying financial statements of the business-type activities of the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District) as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the basic financial statements 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 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 opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of 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 opinions.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System at June 30, 2017 and 2016, and the respective changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3–11, the Schedule of District's Proportionate Share of the Net Pension Liability, and the Schedule of Contributions be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated December 15, 2017, on our consideration of the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System's internal control over compliance.

Ernst + Young LLP

December 15, 2017

# Management's Discussion and Analysis

Years Ended June 30, 2017 and 2016

This management's discussion and analysis of the operational and financial performance of Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District or MIHS) provides an overview of the District's major activities for the years ended June 30, 2017 and 2016. It should be read in conjunction with the accompanying financial statements of the District. The District comprises of Maricopa Medical Center, Desert Vista Behavioral Health, Comprehensive Health Center and 13 Family Health Centers. The financial activities of the District for the years ended June 30, 2017 and 2016 include Maricopa Health Plan (MHP) and Maricopa Care Advantage (MCA), both divisions of the District.

MIHS continues to make substantial improvements in its fiscal health. The 2017 operating loss was reduced by $50 million from 2016 or a total of $93 million since 2015. Many of these improvements can be attributed to "100-Day Work Outs", an aggressive margin improvement initiative which began in fiscal year 2015 and continues to this day. Workouts #4 through #7 were completed during the fiscal year and Workout #8 kicked off on September 21, 2017. This initiative requires that every 100 days, leaders across the company implement eight margin improvement ideas for revenue and expense improvements, essentially making two changes every month. Work Outs #4 – #7 have resulted in validated savings to MIHS of approximately $22 million and $102 million since inception of the program.

MIHS also began a Lean Six Sigma certification program in fiscal year 2017. Lean focuses on speed, eliminating waste, standardization, and flexibility/responsiveness, while Six Sigma seeks to verify root causes of current performance and eliminate variation. This effort is a perfect complement and goes hand in hand with our on-going 100-Day Work Out initiative. MIHS' first inaugural class graduated in December 2016, certified as Lean Six Sigma Yellow Belts, and continued on to become certified as Lean Six Sigma Green Belts. Five of these graduates will become certified trainers to carry forward the Lean Six Sigma principles into our culture so that we have a reservoir of employees who can recognize opportunities, identify root causes of problems, develop quality improvement interventions, and institute meaningful improvements.

Other significant factors that continue to result in improvements in MIHS' operating margin include a continued reduction in uncompensated care primarily for inpatient services and improvements to revenue cycle operations. Uninsured discharges were 21.0% of the total inpatient acute discharges in fiscal year 2014. The January 1, 2014 implementation of the Affordable Care Act (ACA), the State of Arizona's decision to expand the Medicaid program under the ACA and the State's decision to levy a provider assessment to restore the Medicaid program have been the primary reasons for the reduction in MIHS' uninsured populations. By fiscal year 2015, uninsured inpatient discharges were 11.0%, 6.4% in 2016 and 5.6% for 2017.

Significant improvements in revenue cycle operations are also contributing to MIHS’ sustained financial improvements. During fiscal year 2016, under the direction of new revenue cycle leadership, many changes began to be made in all areas of the revenue cycle from scheduling, registration, coding, charge capture, clinical documentation, utilization review and billing, to the final collection of accounts. These improvements continued throughout fiscal year 2017 and are on-going. Substantial investments were made by the organization over the last two years in human resources for these areas, the care management/utilization review function was brought under the revenue cycle umbrella, and a total reorganization was made in the health information management area which includes coding and clinical documentation. MIHS also contracted with nThrive, a revenue cycle management company, in the summer of 2015 to augment MIHS staff and assist in retroactive denials pursuit and accounts receivable collections assistance for accounts over 97 days old. In calendar year 2016, MIHS added discount compliance and underpayment recovery services to the engagement. Since inception, nThrive’s efforts have produced $61 million in collections and have been instrumental in assisting MIHS in identifying areas for improvement.

Last fiscal year, MIHS senior management and the Maricopa County Special Health Care District Board of Directors (District Board) agreed that the sale or joint venture of the health plans needed to be explored and released a Request for Proposal (RFP) to gauge investor interest. MIHS received multiple qualified bids and the District Board unanimously voted on May 25, 2016 to recommend the award of the RFP to United Healthcare Community Plan of Arizona. In October 2016, Arizona Health Care Cost Containment System (AHCCCS) approved the sale and the transaction closed on February 1, 2017 and is recorded under other non-operating revenue. This sale provides an infusion of cash that will allow MIHS to continue its vital mission of serving as the healthcare safety net for citizens of Maricopa County, while providing the cash needed for strategic investments to ensure that MIHS will remain an asset to our community.

On September 28, 2016, the District Board set a roadmap for our organization’s future by receiving the final report resulting from the Proposition 480 implementation planning initiative. This plan will ensure our organization continues to be recognized for high-quality care, innovation and service. It creates a better model of patient care and medical education that improves access, quality, cost and outcomes for patients and increases the supply of future healthcare professionals. On February 22, 2017, the District Board took an important step in achieving the plan’s goal by unanimously approving a contract with Vanir Construction Management, Inc. (Vanir). Vanir was awarded a contract to provide Integrated Program Management Construction Services for the development of a new healthcare campus at the current site of the Maricopa Medical Center and to plan and build new behavioral health capacity and outpatient health care centers across Maricopa County. Vanir will oversee system planning, project execution, construction, cost and quality management.

Other positive news this fiscal year:

- During the year, we celebrated the three-year anniversary of Mercy Maricopa Integrated Care (MMIC), the organization we co-sponsored that received the Regional Behavioral Health Authority contract for managing the health needs of the seriously mentally ill in Maricopa County. MMIC continues to perform well financially, with a positive financial result of $9.7 million for the fiscal year.

- MIHS participated in the June 2017 annual on-site survey with Det Norske Veritas Healthcare, Inc. (DNV) for review of our compliance with the Centers for Medicare & Medicaid (CMS) conditions for participation as a hospital in the United States. The DNV accreditation process provides MIHS with the opportunity to demonstrate to the public that we meet or exceed the standards set forth in the CMS Conditions of Participation. This is the gold standard by which hospitals and health systems are evaluated, and accreditation is also a requirement for receipt of Medicare and Medicaid funding. The survey team recommended DNV re-accreditation.

- MIHS collaborated with MMIC and began operating three new outpatient behavioral health programs across MIHS, including the Family Psycho-Education program at South Central FHC for the family members and significant others of MMIC clients with serious mental illness (SMI), an Assertive Community Treatment team at Desert Vista to serve 100 SMI individuals living in the community and the Early Psychosis Intervention Program at the Pendergast Community Center for treating young people who have been newly diagnosed with schizophrenia or a related psychotic illness. Also in the fiscal year, the District opened a 14 inpatient bed adolescent unit located in MIHS' Desert Vista campus and began renovation of the third floor of Maricopa Medical Center for a 22 inpatient bed unit for patients who have a primary behavioral health diagnosis with severe medical co-morbidities, a service urgently needed in Maricopa County. The unit opened in August 2017 and is currently at capacity.

## Overview of the Financial Statements

The District's financial statements consist of three statements – a statement of net position; a statement of revenues, expenses, and changes in net position; and a statement of cash flows. These statements provide information about the activities of the District, including resources held by the District that are restricted for specific purposes by creditors, contributors, grantors, or enabling legislation. The District is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The statement of net position and statement of revenues, expenses, and changes in net position report the District's net position and changes in it. The District's total net position – the difference between assets plus deferred outflows of resources and liabilities plus deferred inflows of resources – is one measure of the District's financial health or financial position. Over time, increases or decreases in the District's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the District's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients, and local economic factors, should also be considered to assess the overall financial health of the District.

The statement of cash flows reports cash receipts, cash payments, and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash and cash equivalents during the reporting period.

### The District's Net Position

The District's net position represents the difference between its assets plus deferred outflows of resources and liabilities plus deferred inflows of resources reported on the statements of net position. The District's net position at June 30, 2017, 2016, and 2015 was $113,820,853, $(6,785,529), and $(37,102,719), respectively, as shown in Table 1.

**Table 1: Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Net Position**

| | June 30 | | |
|---|---|---|---|
| | **2017** | **2016** | **2015** |
| **Assets** | | | |
| Current assets | **$ 343,448,330** | $ 304,058,423 | $ 216,851,885 |
| Other assets | **70,489,369** | 75,265,320 | 10,000,000 |
| Capital assets | **224,319,648** | 211,250,614 | 226,518,267 |
| Total assets | **638,257,347** | 590,574,357 | 453,370,152 |
| **Deferred outflows of resources** | **62,218,418** | 31,497,747 | 39,764,781 |
| **Liabilities** | | | |
| Current liabilities | **131,385,933** | 149,017,950 | 98,756,762 |
| Long-term debt | **40,387,622** | 81,182,903 | 15,409,250 |
| Risk claims payable, less current portion | **10,088,318** | 11,861,124 | 10,873,379 |
| Net pension liability | **339,937,627** | 334,641,881 | 332,820,645 |
| Other long-term liabilities | **11,777,162** | 9,702,936 | 9,532,058 |
| Total liabilities | **533,576,662** | 586,406,794 | 467,392,094 |
| **Deferred inflows of resources** | **53,078,250** | 42,450,839 | 62,845,558 |
| **Net position** | | | |
| Unrestricted deficit | **(137,643,593)** | (262,587,862) | (256,551,374) |
| Net investment in capital assets | **175,564,826** | 156,217,475 | 217,161,526 |
| Restricted for bonds | **73,256,391** | 97,249,748 | – |
| Restricted for grants | **2,643,229** | 2,335,110 | 2,287,129 |
| Total net position | **$ 113,820,853** | $ (6,785,529) | $ (37,102,719) |

The District's significant assets as of June 30, 2017, 2016, and 2015 were cash and cash equivalents, patient accounts receivable, receivables from AHCCCS, receivables from others, and capital assets.

## Operating Results and Changes in the District's Net Position

For the years ended June 30, 2017, 2016, and 2015, the District's net position increased by $120,606,382, increased by $30,317,190, and decreased by $(39,581,107), respectively, as shown in Table 2. These are made up of several different components, as shown in the following table.

### Table 2: Operating Results and Changes in Net Position

| | Year Ended June 30 | | |
|---|---|---|---|
| | **2017** | **2016** | **2015** |
| **Operating revenues** | | | |
| Net patient service revenue | **$ 391,266,867** | $ 332,646,409 | $ 287,962,633 |
| Capitation and reinsurance | **152,948,996** | 333,340,936 | 286,748,678 |
| AHCCCS medical education revenue | **38,432,067** | 39,611,993 | 24,569,661 |
| Safety net care pool revenue | **–** | – | 2,317,701 |
| Other | **18,432,924** | 16,533,568 | 41,626,068 |
| Total operating revenues | **601,080,854** | 722,132,906 | 643,224,741 |
| **Operating expenses** | | | |
| Salaries and wages | **206,343,120** | 216,324,713 | 215,657,871 |
| Employee benefits | **47,238,559** | 55,407,012 | 62,049,406 |
| Purchased services | **112,887,931** | 126,799,535 | 128,392,524 |
| Medical claims | **126,366,144** | 264,163,953 | 219,178,891 |
| Supplies and other expenses | **110,701,968** | 111,206,947 | 106,420,019 |
| Depreciation | **25,666,488** | 26,894,751 | 28,181,478 |
| Total operating expenses | **629,204,210** | 800,796,911 | 759,880,189 |
| Operating loss | **(28,123,356)** | (78,664,005) | (116,655,448) |
| **Nonoperating revenues (expenses)** | | | |
| Property tax receipts | **110,524,141** | 102,773,760 | 65,822,329 |
| Noncapital grants | **9,411,541** | 8,200,503 | 7,957,019 |
| Noncapital subsidies from State | **3,547,896** | 3,547,896 | 5,000,000 |
| Other nonoperating expenses | **(5,618,980)** | (3,358,337) | (1,450,603) |
| Gain from sale of healthplan membership | **32,373,025** | – | – |
| Interest income | **665,716** | 543,981 | 236,534 |
| Interest expense | **(2,173,601)** | (2,726,608) | (490,938) |
| Total nonoperating revenues | **148,729,738** | 108,981,195 | 77,074,341 |
| Increase (decrease) in net position | **120,606,382** | 30,317,190 | (39,581,107) |
| Net position, beginning of year | **(6,785,529)** | (37,102,719) | 2,478,388 |
| Net position, end of year | **$ 113,820,853** | $ (6,785,529) | $ (37,102,719) |

**Operating Losses**

The first component of the overall change in the District's net position is its operating income or loss – generally, the difference between total operating revenues and total operating expenses incurred to perform those services. Net patient service revenue for the year ended June 30, 2017 was $391,266,867, which includes both inpatient and outpatient services provided to patients. Provision for uncollectible accounts (bad debt expense) is a component of net patient service revenue. In addition to net patient service revenue, the District received capitation and supplemental revenue from its health plan operations of $152,948,996, based on total member months of 535,834.

Other operating revenues included three significant sources of income during the year ended June 30, 2017: (1) the receipt of $5,672,191 of AHCCCS and Medicare disproportionate share funding to assist in providing sufficient resources to offset some of the costs to the facility of serving lower-income and other residents of the County, (2) the receipt of $38,432,067 from AHCCCS for medical education support, and (3) the receipt of $2,426,749 from AHCCCS for trauma services. The operating losses for the years ended June 30, 2017, 2016, and 2015 were $28,123,356, $78,664,005, and $116,655,448, respectively. The primary components of the operating losses for June 30, 2017, 2016, and 2015 were as follows:

- Net patient service revenue of $391,266,867, $332,646,409, and $287,962,633, respectively
- Bad debt expense of $74,368,150, $73,625,191, and $68,903,242, respectively
- Capitation and reinsurance revenue of $152,948,996, $333,340,936, and $286,748,678, respectively. Capitation and reinsurance revenue for the year ended June 30, 2017 was less than prior years due to the sale of the health plan membership on February 1, 2017.
- Salaries and wages of $206,343,120, $216,324,713, and $215,657,871, respectively
- Employee benefit costs of $47,238,559, $55,407,012, and $62,049,406, respectively
- Purchased services of $112,887,931, $126,799,535, and $128,392,524, respectively

- Payments for medical services provided to patients of $126,366,144, $264,163,953, and $219,178,891, respectively. Payment for medical services provided to patients for the year ended June 30, 2017 was less than prior years due to the sale of the health plan membership on February 1, 2017.

**Nonoperating Revenues and Expenses**

Nonoperating revenues and expenses consist primarily of property tax receipts, both for maintenance and operation, and bond debt service. These amounts for the years ended June 30, 2017 and 2016 were $70,777,141 and $67,273,204, and $39,747,000 and $35,500,556, respectively. Also included in nonoperating revenues are noncapital grants and noncapital subsidies from the County/State. These amounts for the years ended June 30, 2017 and 2016 were $9,411,541 and $8,200,503, and $3,547,896, and $3,547,896, respectively. Other nonoperating revenues and expenses consisted primarily of gain from sale of health plan membership, interest income, interest expense and other nonoperating expenses. These amounts for the years ended June 30, 2017 and 2016 were $25,246,160 and $(5,540,964), respectively.

**The District's Cash Flows**

Changes in the District's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses discussed earlier. Net cash used in operating activities for the years ended June 30, 2017, 2016, and 2015 was $(45,490,042), $(73,134,142), and $(84,747,317), respectively.

**Capital Assets**

As of June 30, 2017, the District had $224,319,648 invested in capital assets, net of accumulated depreciation, which includes the capital contribution from Maricopa County. For the years ended June 30, 2017, 2016, and 2015, the District purchased new property and equipment costing $38,736,232, $11,797,148, and $8,534,006, respectively.

## Debt

As of June 30, 2017, the District had bonds payable of $73,000,000. Bond proceeds will be used to purchase various equipment and to fund various improvement projects on the District's existing acute, behavioral health facilities and outpatient health centers. A portion of the bond proceeds, $36,000,000, was used to reimburse the District's general fund for prior capital asset purchases. At June 30, 2017, 2016, and 2015, the District had notes payable to Maricopa County in the amount of $7,024,026, $12,542,265, and $15,433,000, respectively. For the years ended June 30, 2017, 2016, and 2015, the District had capital lease and other long-term obligations totaling $3,759,448, $2,805,866, and $4,702,383, respectively, to various other entities.

## Contacting the District's Financial Management

This financial report is designed to provide the District's patients, suppliers, community members, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to District Administration by telephoning (602) 344-8425.

# Maricopa County Special Health Care District
# d/b/a Maricopa Integrated Health System

## Statements of Net Position

| | June 30 | | | |
|---|---|---|---|---|
| | | **2017** | | **2016** |
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | **$** | **143,829,907** | $ | 128,130,805 |
| Short-term investments | | **9,582,072** | | – |
| Restricted cash – bond | | **38,473,897** | | 36,178,414 |
| Patient accounts receivable, net of allowances of $71,729,000 (2017) and $76,571,000 (2016) | | **68,665,353** | | 64,332,592 |
| Receivable from AHCCCS for medical education (net) | | **38,432,068** | | 39,611,993 |
| Receivable from AHCCCS for health plan premiums | | **14,824,442** | | 9,646,308 |
| Other receivables | | **12,580,841** | | 11,441,192 |
| Due from related parties | | **280,024** | | 114,334 |
| Supplies | | **6,758,322** | | 7,010,417 |
| Prepaid expenses | | **10,021,404** | | 7,592,368 |
| Total current assets | | **343,448,330** | | 304,058,423 |
| | | | | |
| Other assets: | | | | |
| Other assets | | **55,175** | | 4,193,986 |
| Long-term investments | | **35,651,700** | | 10,000,000 |
| Restricted cash – bond | | **34,782,494** | | 61,071,334 |
| Total other assets | | **70,489,369** | | 75,265,320 |
| | | | | |
| Capital assets: | | | | |
| Land | | **13,090,000** | | 13,090,000 |
| Depreciable capital assets, net of accumulated depreciation | | **211,229,648** | | 198,160,614 |
| Total capital assets, net of accumulated depreciation | | **224,319,648** | | 211,250,614 |
| Total assets | | **638,257,347** | | 590,574,357 |
| | | | | |
| **Deferred outflows of resources** | | | | |
| Contributions made after measurement date | | **23,314,715** | | 22,366,096 |
| Difference between expected and actual experience | | **2,065,779** | | 9,131,651 |
| Difference between projected and actual investment earnings | | **36,837,924** | | – |
| Total deferred outflows of resources | **$** | **62,218,418** | $ | 31,497,747 |

*See accompanying notes.*

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

## Statements of Net Position (continued)

| | June 30 | |
|---|---|---|
| | **2017** | **2016** |
| **Liabilities and net assets** | | |
| Current liabilities: | | |
| Current maturities of long-term debt | **$ 43,395,852** | $ 40,165,228 |
| Accounts payable | **29,449,505** | 26,322,155 |
| Accrued payroll and expenses | **19,599,787** | 22,139,941 |
| Medical claims payable | **2,682,699** | 27,511,730 |
| Risk claims payable – current | **1,172,390** | 3,750,613 |
| Payable to AHCCCS for health plan premiums | **7,528,229** | 6,629,727 |
| Overpayments due to third-party payors | **12,165,658** | 14,986,830 |
| Other current liabilities | **15,391,813** | 7,511,726 |
| Total current liabilities | **131,385,933** | 149,017,950 |
| | | |
| Risk claims payable, less current portion | **10,088,318** | 11,861,124 |
| Net pension liability | **339,937,627** | 334,641,881 |
| Other long-term liabilities | **11,777,162** | 9,702,936 |
| Long-term debt | **40,387,622** | 81,182,903 |
| Total liabilities | **533,576,662** | 586,406,794 |
| | | |
| **Deferred inflows of resources** | | |
| Change in proportion and differences between employer contributions and proportionate share of contributions | **11,707,610** | 14,190,736 |
| Difference between projected and actual investment earnings | **–** | 10,724,531 |
| Difference between expected and actual experience | **23,385,224** | 17,535,572 |
| Change in assumptions | **17,985,416** | – |
| Total deferred inflows of resources | **53,078,250** | 42,450,839 |
| | | |
| **Net position** | | |
| Unrestricted deficit | **(137,643,593)** | (262,587,862) |
| Net investment in capital assets | **175,564,826** | 156,217,475 |
| Restricted for bonds | **73,256,391** | 97,249,748 |
| Restricted for grants | **2,643,229** | 2,335,110 |
| Total net position | **$ 113,820,853** | $ (6,785,529) |

*See accompanying notes.*

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

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

| | Year Ended June 30 | |
|---|---|---|
| | **2017** | **2016** |
| Operating revenues: | | |
| Net patient service revenue, net of provision for uncollectible accounts of $74,368,000 (2017) and $73,625,000 (2016) | **$ 391,266,867** | $ 332,646,409 |
| Capitation and reinsurance | **152,948,996** | 333,340,936 |
| AHCCCS medical education revenue | **38,432,067** | 39,611,993 |
| Other | **18,432,924** | 16,533,568 |
| Total operating revenues | **601,080,854** | 722,132,906 |
| | | |
| Operating expenses: | | |
| Salaries and wages | **206,343,120** | 216,324,713 |
| Employee benefits | **47,238,559** | 55,407,012 |
| Purchased services | **112,887,931** | 126,799,535 |
| Medical claims | **126,366,144** | 264,163,953 |
| Supplies and other expenses | **110,701,968** | 111,206,947 |
| Depreciation | **25,666,488** | 26,894,751 |
| Total operating expenses | **629,204,210** | 800,796,911 |
| Operating loss | **(28,123,356)** | (78,664,005) |
| | | |
| Nonoperating revenues (expenses): | | |
| Property tax receipts | **110,524,141** | 102,773,760 |
| Noncapital grants | **9,411,541** | 8,200,503 |
| Noncapital subsidies from State | **3,547,896** | 3,547,896 |
| Other nonoperating expenses | **(5,618,980)** | (3,358,337) |
| Gain from sale of health plan membership | **32,373,025** | – |
| Interest income | **665,716** | 543,981 |
| Interest expense | **(2,173,601)** | (2,726,608) |
| Total nonoperating revenues | **148,729,738** | 108,981,195 |
| | | |
| Increase in net position | **120,606,382** | 30,317,190 |
| | | |
| Net position, beginning of year | **(6,785,529)** | (37,102,719) |
| Net position, end of year | **$ 113,820,853** | $ (6,785,529) |

*See accompanying notes.*

## Maricopa County Special Health Care District
## d/b/a Maricopa Integrated Health System

## Statements of Cash Flows

| | Year Ended June 30 | |
|---|---|---|
| | **2017** | **2016** |
| **Operating activities** | | |
| Receipts from and on behalf of patients | **$ 537,061,930** | $ 662,220,961 |
| Payments to suppliers and contractors | **(378,185,694)** | (497,149,904) |
| Payments to employees | **(276,215,093)** | (269,520,053) |
| Other operating receipts | **78,332,288** | 41,934,191 |
| Other operating payments | **(6,483,473)** | (10,619,337) |
| Net cash used in operating activities | **(45,490,042)** | (73,134,142) |
| | | |
| **Noncapital financing activities** | | |
| Property tax receipts supporting operations | **70,777,141** | 67,273,204 |
| Noncapital contributions and grants received | **9,411,541** | 8,200,503 |
| Noncapital subsidies and other nonoperating receipts | **30,301,941** | 189,560 |
| Net cash provided by noncapital financing activities | **110,490,623** | 75,663,267 |
| | | |
| **Capital and related financing activities** | | |
| Property tax receipts for debt service | **39,747,000** | 35,500,556 |
| Principal payments on long-term debt and capital leases | **(40,787,668)** | (4,787,252) |
| Purchase of capital assets | **(35,512,511)** | (11,627,098) |
| Bond proceeds | **–** | 106,000,000 |
| Interest paid on long-term debt | **(2,173,601)** | (2,726,608) |
| Net cash (used in) provided by capital and related financing activities | **(38,726,780)** | 122,359,598 |
| | | |
| **Investing activities** | | |
| Purchases of investments, net | **(35,233,772)** | – |
| Interest from investments | **665,716** | 543,981 |
| Net cash (used in) provided by investing activities | **(34,568,056)** | 543,981 |
| | | |
| (Decrease) increase in cash and cash equivalents | **(8,294,255)** | 125,432,704 |
| Cash and cash equivalents, beginning of year | **225,380,553** | 99,947,849 |
| Cash and cash equivalents, end of year | **$ 217,086,298** | $ 225,380,553 |

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Statements of Cash Flows (continued)

| | Year Ended June 30 | |
|---|---|---|
| | **2017** | **2016** |
| **Reconciliation of operating loss to net cash used in operating activities** | | |
| Operating loss | **$ (28,123,356)** | $ (78,664,005) |
| Depreciation | **25,666,488** | 26,894,751 |
| Provision for uncollectible accounts | **74,368,150** | 73,625,191 |
| Changes in operating assets and liabilities: | | |
| Patient, other accounts receivable, and other assets | **(79,699,958)** | (99,303,524) |
| Due from related parties | **(165,690)** | 131,771 |
| Supplies and prepaid expenses | **(2,176,941)** | (1,492,592) |
| Estimated amounts due from/to third-party payors | **(2,821,172)** | 3,958,820 |
| Medical claims payable | **(24,829,031)** | 7,476,617 |
| Risk claims payable | **(4,351,029)** | 1,358,536 |
| Accounts payable and accrued expenses | **(3,357,503)** | (7,119,707) |
| Net cash used in operating activities | **$ (45,490,042)** | $ (73,134,142) |

*See accompanying notes.*

## 1. Nature of Operations and Summary of Significant Accounting Policies

### Nature of Operations and Reporting Entity

Maricopa County Special Health Care District (the District) d/b/a Maricopa Integrated Health System (MIHS) is a health care district and political subdivision of the state of Arizona. The District is located in Phoenix, Arizona, and is governed by a five-member board of directors elected by voters within the District.

The District was created in November 2003 by an election of the voters of Maricopa County, Arizona (the County). In November 2004, the voters first elected the District's governing board. An Intergovernmental Agreement (IGA) between the District and the County was entered into in November 2004, which, among other things, specified the terms by which the County transferred essentially all of the assets, liabilities, and financial responsibility of MIHS to the District effective January 1, 2005. MIHS operates a medical center facility (the Medical Center), which was formerly owned and operated by the County; freestanding inpatient behavioral health facilities located on the Medical Center campus and in Mesa, Arizona; a specialty clinic located on the Medical Center campus; and various outpatient health centers throughout Maricopa County. The District has the authority to levy ad valorem taxes. The District had no significant operations prior to January 1, 2005. In conjunction with the IGA, the County and the District entered into a 20-year lease for the Medical Center real estate.

On September 3, 2013, a second Amended and Restated Intergovernmental Agreement (the Amended IGA) was entered into by the District whereby all the land and real property located at the Maricopa Medical Center and Desert Vista campuses (the Property) subject to the prior 20-year lease were donated to the District. The Property was recorded at its fair value at date of donation, determined by a third-party valuation services firm, totaling $117,075,000. The Property donated consisted of land of $9,000,000, buildings of $104,375,000 and land improvements of $3,700,000.

The Amended IGA also provided for the District's purchase of supplies from the County and the sublease of certain space to the County, and for the County to be able to purchase supplies and utilize the District's services, among other items.

If the Property is not used for county hospital purposes, the Property shall (at the election of the County) revert to the County.

**1. Nature of Operations and Summary of Significant Accounting Policies (continued)**

Effective October 1, 2005, the District assumed the operations and financial responsibility for the Maricopa Health Plan (MHP), a managed care plan previously operated by the County. MHP contracts with the Arizona Health Care Cost Containment System (AHCCCS) to arrange and provide health care services to Medicaid-eligible clients. In March 2013, MHP was awarded a new five-year contract with AHCCCS to operate MHP through September 30, 2018. This contract must be approved by AHCCCS on a year-to-year basis. MIHS has a management agreement with Banner Health to provide day-to-day management of MHP, including providing all employees and infrastructure necessary to operate MHP. MHP is an operating division of the District.

The AHCCCS contract awarded to MHP in March 2013 required that each successful contractor establish a Medicare Advantage Coordinated Care Plan. In September 2013, the Centers for Medicare & Medicaid Services (CMS) approved a contract with the District to operate Maricopa Care Advantage (MCA) for one year effective January 1, 2014, with renewals for successive one-year periods in accordance with the terms of the agreement. MIHS amended its management agreement with Banner Health to provide day-to-day management of MCA, including providing all employees and infrastructure necessary to operate MCA. MCA is a contract of the District.

In May 2016, the District awarded the transfer of membership of MHP and MCA to United Healthcare Community Plan of Arizona. AHCCCS approved the transfer of membership in October 2016. The sale of membership was finalized in February 2017, for a sale price of approximately $32,000,000.

In April 2014, Mercy Maricopa Integrated Care (MMIC) began operations. MMIC was formed to respond to a legal solicitation issued jointly by the Arizona Department of Health Services (ADHS) and AHCCCS. The purpose of the solicitation was to award a contract to the successful bidder to become the Maricopa County Regional Behavioral Health Authority (RBHA). The RBHA provides integrated health care services, both medical and behavioral health, to Medicaid-eligible adults with serious mental illnesses. ADHS awarded the contract to MMIC on March 25, 2013. The District retains a 15% ownership in the venture and has a 25% representation on the governing body. Under the MMIC bylaws approved in final form on September 9, 2013, the District is one of the four members entitled to vote for MMIC's directors. The District's capital contribution to MMIC of $10,000,000 is accounted for under the cost method of accounting.

The District primarily earns revenues by providing inpatient and outpatient medical and nursing services and operating a managed care plan for Medicaid-eligible patients.

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

### Basis of Accounting and Presentation

The District prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board. The financial statements of the District have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets, and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated and voluntary non-exchange transactions (principally federal and state grants and appropriations from the County) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated, non-exchange transactions. Government-mandated, non-exchange transactions that are not program-specific (such as appropriations from the County); investment income; and interest on capital assets-related debt are included in nonoperating revenues and expenses. The District first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

### Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all liquid investments, including restricted assets with original maturities of three months or less, to be cash equivalents. At June 30, 2017 and 2016, the District had approximately $217,086,000 and $225,381,000, respectively, of cash and cash equivalents.

### Restricted Cash

Restricted cash includes cash and cash equivalents that are restricted for use and includes approximately $38,474,000 of tax proceeds restricted for debt service on the general obligation bonds and approximately $34,782,000 of bond proceeds restricted for use under the bond agreement. A portion of the restricted cash has been classified as a long-term asset as the funds will be used to purchase long-term assets (see Note 12).

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

### Investments

The District records its investments in accordance with Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures,* which amended GASB Statement No. 3, *Deposits with Financial Institutions*, *Investments (including Repurchase Agreements), and Reverse Purchase Agreements* and GASB Statements No. 72, *Fair Value Measurement and Application.*

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. These guidelines recognize a three-tiered fair sale heirachy, as follows:

- Level 1: Unadjusted quoted prices for identical investments in active markets
- Level 2: Observable inputs other than quoted market princes
- Level 3: Unobservable inputs

### Risk Management

The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries; medical malpractice; and natural disasters. The District participated in the County's self-insurance program through December 3, 2012. The IGA between the District and County was amended to reflect that the District would no longer participate in the County's self-insurance program effective December 4, 2012, except for workers' compensation claims. The IGA also stipulated that the County would provide a mutually agreed-upon amount to fund estimated outstanding losses and estimated future claim payments for the period January 1, 2005 through December 3, 2012. In return, the District accepted responsibility for the payment and management of these claims on an ongoing basis.

The District, through its Risk Management Department, is now responsible for identifying and resolving exposures and claims that arise from employee work-related injury, third-party liability, property damage, regulatory compliance, and other exposures arising from the District's operations. Effective December 4, 2012, the District's Board of Directors approved and

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

implemented risk management, self-insurance, and purchased insurance programs under the Maricopa Integrated Health System Risk Management Insurance and Self-Insurance Plan (the Insurance Plan). As authorized under the Insurance Plan, the District purchases excess insurance over the District's self-insured program to maintain adequate protection against the District's exposures and claims filed against the District. It is the District's policy to record the expense and related liability for professional liability, including medical malpractice and workers' compensation, based upon annual actuarial estimates.

MHP receives insurance coverage from the state of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The reinsurance expense is reflected as reduced capitation rates paid to MHP. Under the state program, risk of loss from 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 75% to 85%, with no maximum annual benefit. Eligible reinsurance claims are reported as a reduction of health care expenses at the amount expected to be collected from AHCCCS.

### Patient Accounts Receivable

The District reports patient accounts receivable for services rendered at estimated net realizable amounts due from third-party payors, patients, and others. The District provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information, and existing economic conditions. As a service to the patient, the District bills third-party payors directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

### Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

**1. Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Capital Assets**

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. The dollar threshold to capitalize capital assets is $2,500. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are amortized over the shorter of the lease term or the assets' respective estimated useful lives. The following estimated useful lives are being used by the District:

| | |
|---|---|
| Land improvements | 2–25 years |
| Buildings and leasehold improvements | 5–40 years |
| Equipment | 3–20 years |

**Compensated Absences**

District policies permit most employees to accumulate vacation and sick leave benefits (personal leave) that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as personal leave benefits and are earned whether the employee is expected to realize the benefit as time off or as a cash payment. Employees may accumulate up to 240 hours of personal leave, depending on years of service, but any personal leave hours in excess of the maximum amount that are unused by the calendar year-end are converted to the employee's extended illness bank (EIB). Generally, EIB benefits are used by employees for extended illness or injury, or to care for an immediate family member with an extended illness or injury. EIB benefits are cumulative but do not vest with employees and, therefore, are not accrued. However, upon retirement, employees with accumulated EIB in excess of 1,000 hours are entitled to a $3,000 bonus. The total compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes, computed using rates in effect at that date.

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

### Net Position

Net position of the District is classified into three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted net position consists of noncapital assets that must be used for a particular purpose as specified by creditors, grantors, or donors external to the District. Unrestricted net position consists of the remaining assets plus deferred outflows of resources less remaining liabilities plus deferred inflows of resources that do not meet the definition of net investment in capital assets, or restricted net position.

### Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such estimated amounts are revised in future periods as adjustments become known. The District participates in the Federally Qualified Health Center (FQHC) program and receives supplemental payments from AHCCCS. The payments are made based on information filed with AHCCCS on the Annual Reconciliation and Rebase Data (ARRD) report. The District recognized a $5,650,000 increase in total operating revenue in FY 2017 based on additional information received upon filing the 2016 ARRD report. The District is waiting for a response from AHCCCS in regard to the 2016 ARRD filing.

### Other Health Plan Receivables From AHCCCS

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 other health plan receivables from AHCCCS. 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.

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Receivable from AHCCCS for health plan premiums represents management's best estimate of amounts to be received and are 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.

### Medical Claims Payable

The costs of hospital and medical services provided to enrollees served under the contract are accrued in the period that the services are rendered. 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 by an independent actuary 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 Note 9).

### Charity Care

The District provides services at amounts less than its established rates to patients who meet the criteria of its charity care policy. The criteria for charity care take into consideration the patient's family income in relation to the federal poverty guideline and type of service rendered.

The total net cost of charity care provided was approximately $31,921,000 and $41,421,000 for the years ended June 30, 2017 and 2016, respectively. Charity care cost is based on the percentage of total direct operating expenses less other operating revenue divided by the total gross revenue for the Medical Center. This percentage is applied to the amount written off as charity care to determine the total charity care cost. The net cost of charity care is total charity care cost less any payments received. Payments received were approximately $5,777,000 and $6,623,000 for the years ended June 30, 2017 and 2016, respectively.

**1. Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Property Taxes**

On or before the third Monday in August, the County levies real property taxes and commercial personal property taxes on behalf of the District, which become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May.

The County also levies mobile home personal property taxes on behalf of the District that are due the second Monday of the month following receipt of the tax notice and become delinquent 30 days later. A lien assessed against real and personal property attaches on the first day of January preceding assessment and levy.

Proposition 480 allows the County to levy additional property taxes for principal and interest debt service related to general obligation bonds (see Note 11).

**Income Taxes**

The District is a health district and political subdivision of the state of Arizona and is exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

**Pensions**

The District adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective July 1, 2014. The statement establishes standards for recognition, measurement, and presentation of pension information, including pension liability, deferred outflows and inflows of resources, and expenses related to pension benefits.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Arizona State Retirement System (ASRS) and additions to/deductions from ASRS's fiduciary net position have been determined on the same basis as they are reported by ASRS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

## 1. Nature of Operations and Summary of Significant Accounting Policies (continued)

### New Accounting Pronouncements

The GASB issued GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, in June 2015. The standard addresses employers' accounting and financial reporting for OPEB benefits. The standard is effective for the District as of July 1, 2017. The District is evaluating the impact of adopting the accounting standard.

The GASB issued GASB Statement No. 82, *Pension Issues*, in March 2016. The standard addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee contribution requirements. This Statement amends Statement 68 to require presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based. This Statement clarifies that a deviation from the guidance in an Actuarial Standard of Practice is not considered to be in conformity with the requirements of Statement 68 or Statement 73 for the selection of assumptions used in determining the total pension liability and related measures. This Statement clarifies that payments that are made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as employee contributions for purposes of Statement 68. The standard was effective for the District as of July 1, 2016.

The GASB issued GASB Statement No. 87, *Leases*, in June 2017. The standard requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases. The guidance establishes a single model for lease accounting based on the principle that leases are financing the right to use an underlying asset. The standard is effective for the District as of July 1, 2019. The District is evaluating the impact of adopting the accounting standard.

## 2. Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. These payment arrangements include the following:

- Medicare – Inpatient acute care services, certain inpatient non-acute care services, and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, acuity, and other factors. Inpatient psychiatric services are paid based on a blended cost reimbursement methodology and prospectively determined rates. The District is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare fiscal intermediary. The Medicare fiscal intermediary has audited the District's cost reports through June 30, 2015.

- AHCCCS – Inpatient acute services are paid at prospectively determined rates. Inpatient psychiatric services are paid on a per diem basis. Outpatient services rendered to AHCCCS program beneficiaries are primarily reimbursed under prospectively determined rates.

- The District has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Approximately 56% and 62% of net patient service revenues were from participation in the Medicare and state-sponsored AHCCCS programs for the years ended June 30, 2017 and 2016, respectively. Laws and regulations governing the Medicare and AHCCCS programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

Net patient service revenue increased by approximately $591,000 and $914,000 in 2017 and 2016, respectively, due to changes in estimates related to final settlements with the Medicare program and cost reports that are no longer subject to audits, reviews, or investigations. Net patient service revenue increased by approximately $10,854,000 in 2017 due to a change in estimate related to net realizable value of accounts receivable.

### 3. AHCCCS Safety Net Care Pool

The District participated in the AHCCCS Safety Net Care Pool (SNCP) program that provides reimbursement to Safety Net Hospitals for uncompensated cost incurred in providing services to Medicaid and uninsured/underinsured patients. The program was terminated by AHCCCS effective December 31, 2013. Amounts recorded under the SNCP program are subject to final settlement by AHCCCS, and the District does not expect final settlement until fiscal 2018. The District has established a reserve for potential overpayment, totaling approximately $1,317,000 at June 30, 2017 and 2016. Upon final settlement, amounts previously recorded could change by material amounts. Management believes amounts recorded under the SNCP program are adequate.

### 4. Deposits and Investment Income

The District's deposits are held by the County on separate accounts, and the District can draw them upon demand. The District maintains three primary depository accounts for the Medical Center, MHP, and MCA. A compensating balance is maintained in these accounts at a sufficient amount so that earnings on these accounts offset the fees charged for services. Any amounts above the compensating balance are swept daily overnight into a commercial paper investment account.

### Fair Value Measurements

The District categorizes its fair value measurements within the fair value hierarchy established by U.S. generally accepted accounting principles. The hierarchy is based on the inputs used in valuation and gives the highest priority to unadjusted quoted prices in active markets and requires that observable inputs be used in the valuation when available. The disclosure of fair value estimates in the hierarchy is based on whether the significant inputs into the valuations are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest level, Level 1, is given to unadjusted quoted prices in active markets and the lowest level, Level 3, to unobservable inputs.

Level 1: Valuations based on unadjusted quoted prices for identical instruments in active markets that the District has the ability to access.

Level 2: Valuations based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments that are not active, and model-driven valuations in which all significant inputs are observable.

**4. Deposits and Investment Income (continued)**

Level 3: Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In instances where inputs used to measure fair value fall into different levels, fair value measurements in their entirety are categorized based on the lowest level of input that is significant to the valuation. The District's assessment of the significance of particular inputs to these measurements requires judgment and considers factors specific to each investment. The table below shows the fair value leveling of the District's investments as of June 30, 2017:

| | June 30, 2017 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Government bonds | $ 3,194,874 | $ – | $ – | $ 3,194,874 |
| Government agencies | 25,664,562 | – | – | 25,664,562 |
| Short-term bill and notes | 6,374,336 | – | – | 6,374,336 |
| | $ 35,233,772 | $ – | $ – | $ 35,233,772 |

### Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a bank failure, an entity's deposits may not be returned to it. The District's deposit policy for custodial credit risk requires compliance with the provisions of state law.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. At June 30, 2017, the District's funds were held in cash and cash equivalents and carrying value equates to fair value.

## 4. Deposits and Investment Income (continued)

At June 30, 2017, the District had the following investments with the respective weighted-average maturity in years:

| | June 30, 2017 | |
|---|---|---|
| | Fair Value | Weighted-Average Maturity |
| Government bonds | $ 3,194,874 | 0.09 |
| Government agencies | 25,664,562 | 1.09 |
| Short-term bills and notes | 6,374,336 | 0.09 |
| | $ 35,233,772 | 1.27 |

### Credit Risk

Credit risk is the risk that the counterparty to an investment will not fulfill its obligation. At June 30, 2017, the District's funds were held by Northern Trust Bank. The District has adopted an investment policy that authorizes the following instruments for investment: (1) negotiable direct obligations of, or obligations the principal and interest of which are unconditionally guaranteed by, the United States government; (2) obligations of federal agencies and instrumentalities; (3) interest-bearing notes, bonds, debentures, and other such evidence of indebtedness with a fixed maturity of any domestic listed corporation within the United States that when purchased carry ratings in one of the three highest classifications of at least two nationally recognized debt rating agencies; and (4) municipal bond investments that carry ratings in one of the top two classifications of at least two nationally recognized rating agencies or secured by bond insurance.

**5. Patient Accounts Receivable**

The District grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payor agreements. Patient accounts receivable consisted of the following at June 30:

| | 2017 | 2016 |
|---|---|---|
| Medicare | **$ 14,637,400** | $ 13,677,857 |
| AHCCCS | **30,762,163** | 29,054,844 |
| Other third-party payors | **68,505,024** | 58,474,092 |
| Patients | **26,489,962** | 39,697,117 |
| | **140,394,549** | 140,903,910 |
| Less allowance for uncollectible accounts | **71,729,196** | 76,571,318 |
| | **$ 68,665,353** | $ 64,332,592 |

**6. Other Receivables**

At June 30, 2017 and 2016, significant components of other receivables included amounts due from District Medical Group of approximately $2,500,000 and $2,300,000, respectively. Additional amounts receivable at June 30, 2017 and 2016, include an amount receivable related to HomeAssist Health of approximately $2,000,000 and $2,002,000, respectively, which was fully reserved of June 30, 2017.

**7. Receivables From AHCCCS for Medical Education**

During the years ended June 30, 2017 and 2016, MIHS entered into an intergovernmental agreement with AHCCCS such that AHCCCS provided available medical education funds from CMS. At June 30, 2017 and 2016, available funds from CMS for medical education totaled approximately $55,570,000 and $57,571,000, respectively. At June 30, 2017 and 2016, the amount due to MIHS is approximately $38,432,000, which is net of the $17,138,000 matching funds provided by MIHS, and $39,612,000, which is net of the $17,959,000 matching funds provided by MIHS, respectively.

## 8. Capital Assets

Capital assets activity for the year ended June 30, 2017 was as follows:

| | Beginning Balance | Additions | Disposals | Transfers | Adjustments | Ending Balance |
|---|---|---|---|---|---|---|
| Capital assets not being depreciated: | | | | | | |
| Construction-in-progress | **$ 9,309,090** | **$ 35,389,392** | **$ –** | **$ (11,891,937)** | **$ –** | **$ 32,806,545** |
| Capitalized software-in-progress | **330,830** | **–** | **–** | **–** | **(711)** | **330,119** |
| Land | **13,090,000** | **–** | **–** | **–** | **–** | **13,090,000** |
| Capital assets being depreciated: | | | | | | |
| Buildings and leasehold improvements | **198,951,821** | **–** | **–** | **3,229,213** | **–** | **202,181,034** |
| Capitalized software | **49,516,241** | **–** | **–** | **–** | **–** | **49,516,241** |
| Equipment | **121,930,799** | **3,346,841** | **–** | **8,662,724** | **–** | **133,940,364** |
| | **393,128,781** | **38,736,233** | **–** | **–** | **(711)** | **431,864,303** |
| Less accumulated depreciation: | | | | | | |
| Buildings and leasehold improvements | **53,862,028** | **10,624,547** | **–** | **–** | **–** | **64,486,575** |
| Capitalized software | **36,107,821** | **4,683,631** | **–** | **–** | **–** | **40,791,452** |
| Equipment | **91,908,318** | **10,358,310** | **–** | **–** | **–** | **102,266,628** |
| | **181,878,167** | **25,666,488** | **–** | **–** | **–** | **207,544,655** |
| Capital assets, net | **$ 211,250,614** | **$ 13,069,745** | **$ –** | **$ –** | **$ (711)** | **$ 224,319,648** |

Capital assets activity for the year ended June 30, 2016 was as follows:

| | Beginning Balance | Additions | Disposals | Transfers | Ending Balance |
|---|---|---|---|---|---|
| Capital assets not being depreciated: | | | | | |
| Construction-in-progress | $ 902,058 | $ 11,789,774 | $ – | $ (3,382,742) | $ 9,309,090 |
| Capitalized software-in-progress | 323,456 | 7,374 | – | – | 330,830 |
| Land | 13,090,000 | – | – | – | 13,090,000 |
| Capital assets being depreciated: | | | | | |
| Buildings and leasehold improvements | 197,595,323 | – | – | 1,356,498 | 198,951,821 |
| Capitalized software | 49,516,241 | – | – | – | 49,516,241 |
| Equipment | 120,428,193 | – | (523,638) | 2,026,244 | 121,930,799 |
| | 381,855,271 | 11,797,148 | (523,638) | – | 393,128,781 |
| Less accumulated depreciation: | | | | | |
| Buildings and leasehold improvements | 43,548,433 | 10,313,595 | – | – | 53,862,028 |
| Capitalized software | 30,202,539 | 5,905,282 | – | – | 36,107,821 |
| Equipment | 81,586,032 | 10,675,874 | (353,588) | – | 91,908,318 |
| | 155,337,004 | 26,894,751 | (353,588) | – | 181,878,167 |
| Capital assets, net | $ 226,518,267 | $ (15,097,603) | $ (170,050) | $ – | $ 211,250,614 |

## 9. Medical Claims Payable

Medical claims liability consists of the following at June 30:

| | 2017 | 2016 |
|---|---|---|
| Claims payable or pending approval | **$ 1,051,311** | $ 18,696,888 |
| Provisions for claims incurred but not yet reported | **1,631,388** | 8,814,842 |
| | **$ 2,682,699** | $ 27,511,730 |

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. Accrued claims payable are estimated based on historical claims payments and other relevant information. Unpaid claims adjustment expenses are an estimate of the cost to process the incurred but not reported claims and are included in medical claims payable. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims paid is dependent on future developments, management is of the opinion that the accrued medical claims payable is adequate.

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

| | 2017 | 2016 |
|---|---|---|
| Beginning balance | **$ 27,511,730** | $ 20,035,113 |
| Incurred: | | |
| Current | **127,439,180** | 271,504,595 |
| Prior | **4,910,314** | 4,196,361 |
| Total | **132,349,494** | 275,700,956 |
| Paid: | | |
| Current | **124,756,481** | 243,304,826 |
| Prior | **32,422,044** | 24,919,513 |
| Total | **157,178,525** | 268,224,339 |
| Ending balance | **$ 2,682,699** | $ 27,511,730 |

## 9. 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. Medical claims expense of approximately $126,366,000 and $264,164,000 on the statements of revenues, expenses, and changes in net position is recorded net of reinsurance revenue for the years ended June 30, 2017 and 2016, respectively.

## 10. Risk Claims Payable

The District maintains insurance through a combination of programs of purchased commercial insurance and self-insurance for professional liability claims, including medical malpractice and workers' compensation claims. The District is self-insured for workers' compensation in Arizona. In connection with the aforementioned programs, the District has accrued estimates for asserted and incurred but not reported claims. The actuarially determined claims payable is approximately $11,260,000 and $15,612,000, of which $1,172,000 and $3,751,000 has been recorded as a current liability and approximately $10,088,000 and $11,861,000 has been recorded as a noncurrent liability on the accompanying statements of net position as of June 30, 2017 and 2016, respectively. Risk claims payable are undiscounted.

As of June 30, 2017, the District maintained commercial insurance as follows:

| Insurance | Limits | Self-Insured Retention/Deductible |
|---|---|---|
| Workers' compensation | Statutory | $500,000 each claim |
| Medical malpractice | $25,000,000 each incident – first layer | |
| | Additional $10,000,000 – second excess layer | $2,000,000 each incident |

The insurance policies listed above became effective December 1, 2012 and remain current through June 30, 2017.

## 10. Risk Claims Payable (continued)

The following is a reconciliation of the risk claims payable as for the years ended June 30:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Beginning balance | **$ 15,611,737** | $ 14,253,201 | $ 15,780,832 |
| Total incurred | **5,167,506** | 4,037,496 | 1,332,433 |
| Total paid | **(9,518,535)** | (2,678,960) | (2,860,064) |
| Ending balance | **$ 11,260,708** | $ 15,611,737 | $ 14,253,201 |

## 11. Long-Term Debt and Capital Leases

The following is a summary of long-term debt transactions for the District for the years ended June 30:

| | Beginning Balance | Additions | Payments | Ending Balance | Current Portion |
|---|---|---|---|---|---|
| **2017** | | | | | |
| General obligation bonds | **$ 106,000,000** | **$ –** | **$ (33,000,000)** | **$ 73,000,000** | **$ 36,000,000** |
| Note payable and credit facility, Maricopa County | **12,542,265** | **–** | **(5,518,239)** | **7,024,026** | **5,604,146** |
| Capital lease obligations | **2,805,865** | **3,223,012** | **(2,269,429)** | **3,759,448** | **1,791,706** |
| Total long-term debt | **$ 121,348,130** | **$ 3,223,012** | **$ (40,787,668)** | **$ 83,783,474** | **$ 43,395,852** |
| **2016** | | | | | |
| General obligation bonds | $ – | $ 106,000,000 | $ – | $ 106,000,000 | $ 33,000,000 |
| Note payable and credit facility, Maricopa County | 15,433,000 | – | (2,890,735) | 12,542,265 | 5,518,239 |
| Capital lease obligations | 4,702,383 | – | (1,896,518) | 2,805,865 | 1,646,989 |
| Total long-term debt | $ 20,135,383 | $ 106,000,000 | $ (4,787,253) | $ 121,348,130 | $ 40,165,228 |

## 11. Long-Term Debt and Capital Leases (continued)

### General Obligation Bonds

On November 4, 2014, the voters of Maricopa County approved Proposition 480. Proposition 480 allows the District to issue up to $935,000,000 in general obligation bonds to be repaid over 30 years to fund outpatient health facilities, including improvement or replacement of existing outpatient health centers; construction of new outpatient health centers in northern, eastern, and/or western Maricopa County, behavioral health facilities, including construction of a new behavioral health hospital; and acute care facilities, including replacement of the District's public teaching hospital Maricopa Medical Center and its Level One Trauma Center and Arizona Burn Center, on the existing campus.

On August 6, 2015, the District closed its first offering of general obligation bonds in the amount of $106,000,000 in order to start various improvement projects on its existing outpatient health centers and behavioral health facilities. The bonds bear interest at the rate of 2.450% through maturity in 2019. A portion of the $106,000,000 bond proceeds was also used to reimburse the District's general fund for prior capital asset purchases totaling $36,000,000.

Proposition 480 allows the County to levy additional property taxes for principal and interest debt service related to the general obligation bonds.

The bond purchase agreement also contains certain nonfinancial covenants, including the maintenance of property and annual reporting requirements. Management believes it is in compliance with these covenant requirements at June 30, 2017.

### Note Payable and Credit Facility, Maricopa County

As part of the IGA, the District issued a note payable to the County for $433,000, which was due in August 2015. This amount relates to the cost incurred by the County on behalf of the District in relation to the election held in November 2004. This note payable to the County was interest free for the first five years. The note bore interest at a rate of 1.52% through its original maturity in 2015.

The County agreed to extend the District a $15,000,000 credit facility in connection with the IGA. Any amounts borrowed under the credit facility were previously payable to the County in their entirety in August 2015. Borrowings under this credit facility are $15,000,000 and were interest free for the first five years.

## 11. Long-Term Debt and Capital Leases (continued)

On October 7, 2015, the District and Maricopa County signed a third amendment to the original IGA dated August 10, 2005, in relation to the Assistance Package. The new agreement includes repayment of the original principal amount of $15,433,000 plus unpaid accrued interest of $1,152,000 plus accrued interest only on the principal sum of $15,433,000 beginning August 1, 2015. The payments are to be made in 12 equal installments of $1,414,000: the first installment was paid on November 30, 2015, and the 12th and final installment is due on August 31, 2018.

Scheduled maturities of long-term debt, excluding capital lease payments, for the years ending June 30 are as follows:

| | |
|---|---|
| 2018 | $ 41,604,146 |
| 2019 | 38,419,880 |
| | $ 80,024,026 |

## Capital Lease Obligations

The District is obligated under the leases for buildings, building improvements, and equipment, through 2018, which are accounted for as capital leases. Assets under capital leases at June 30, 2017 and 2016, had a total cost of $16,849,000 and $13,502,000, respectively, with accumulated depreciation of $12,849,000 and $11,237,000, respectively.

The following is a schedule by year of future minimum lease payments under the capital leases, including interest at varying rates together with the present value of the future minimum lease payments as of June 30, 2017:

| | Principal | Interest |
|---|---|---|
| Year ending June 30: | | |
| 2018 | $ 1,791,706 | $ 143,743 |
| 2019 | 675,087 | 94,213 |
| 2020 | 714,248 | 55,052 |
| 2021 | 578,407 | 15,209 |
| | $ 3,759,448 | $ 308,217 |

## 12. Restricted Net Position

Restricted net position at June 30, 2017 consists of grant funds received for specific purposes that are expected to be expended during 2018 in the amount of $2,643,229. Restricted net position at June 30, 2016 consisted of grant funds received for specific purposes that were expected to be expended during 2017 in the amount of $2,335,110.

Restricted net position at June 30, 2017 and June 30, 2016 also consists of bond funds expected to be expended specific purposes as defined in the bond agreement, in the amount of approximately $73,256,000 and $97,250,000, respectively.

## 13. Pension Plan

### General Information About the Pension Plan

*Plan Description*

The District contributes to a cost-sharing, multiple-employer, defined benefit pension plan administered by the ASRS. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. ASRS is governed by the ASRS Board according to the provisions of Arizona Revised Statutes Title 38, Chapter 5, Article 2.

ASRS issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910, or by telephoning (602) 240-2000 or (800) 621-3778.

*Funding Policy*

The Arizona State Legislature establishes and may amend contribution rates for active plan members and the District. For the years ended June 30, 2017 and 2016, active plan members and the District were required by statute to contribute at the actuarially determined rate of 11.48% (11.34% retirement and 0.14% long-term disability) and 11.47% (11.35% retirement and 0.12% long-term disability), respectively, of the members' annual covered payroll.

**13. Pension Plan (continued)**

*Benefits Provided*

ASRS provides retirement, healthcare, and long-term disability benefits. The Defined Benefit Plan provides a monthly retirement benefit to a member who has reached retirement eligibility criteria, terminated employment, and applied for retirement benefits. At retirement, members have seven different payment options to choose from, including a straight-life annuity that guarantees monthly payments only for the lifetime of the member, or term certain and joint and survivor annuities that will continue to make monthly payments to a beneficiary in the event of the member's death. The amount of a member's monthly benefit is calculated based on his or her age, his or her years of service, his or her salary at retirement, and the retirement option chosen. To learn more, visit the basic benefit calculator page. In the event a member dies before reaching retirement eligibility criteria, the defined benefit plan will pay a lump sum or annuity to the member's beneficiary(ies). The Retiree Health Benefit Supplement (also called Premium Benefit Supplement) provides health insurance coverage for retirees and a monthly health insurance premium benefit to offset the cost of retiree health insurance. Long Term Disability (LTD) provides a monthly disability benefit to partially replace income lost as a result of disability.

*Contributions*

The contribution rate is calculated by an independent actuary at the end of each fiscal year based on the amount of investment assets the ASRS has on hand to pay benefits, liabilities associated with the benefits members have accrued to date, projected investment returns, and projected future liabilities.

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions*

At June 30, 2017, the District reported a liability of approximately $339,938,000 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015, and was rolled forward using generally accepted actuarial procedures to June 30, 2016. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers and the state, as actuarially determined. At June 30, 2016, the District's proportion was 2.11%, which was a decrease of 0.04% from its proportion measured as of June 30, 2015.

**13. Pension Plan (continued)**

For the years ended June 30, 2017 and 2016, the District recognized pension expense of $7,547,000 and $10,759,000, respectively. At June 30, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Differences between expected and actual experience | $ 2,065,779 | $ (23,385,224) |
| Net difference between projected and actual earnings on pension plan investments | 36,837,924 | – |
| Changes in proportion and differences between district contributions and proportionate share of contributions | – | (11,707,610) |
| Changes in assumptions | – | (17,985,416) |
| District contributions subsequent to the measurement date | 23,314,715 | – |
| Total | $ 62,218,418 | $ (53,078,250) |

Of the amount reported as deferred outflows of resources, $23,314,715 related to pension results from district contributions subsequent to the measurement date that will be recognized as a reduction of the net pension liability in the year ending June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense through 2021 as follows:

| | |
|---|---|
| Year ending June 30: | |
| 2018 | $ (24,037,224) |
| 2019 | (15,040,688) |
| 2020 | 14,574,118 |
| 2021 | 10,329,246 |

**13. Pension Plan (continued)**

*Actuarial Assumptions*

The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|---|---|
| Inflation | 3.00% |
| Salary increases | 3.00% – 6.75% average, including inflation |
| Investment rate of return | 8.75%, net of pension plan investment expense, including inflation |

Mortality rates were based on the 1994 GAM, sex-distinct, projected to 2015 using Scale BB.

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2007 – June 30, 2012. The ASRS Board adopted the experience study, which recommended changes, and those changes were effective as of the June 30, 2013 actuarial valuation.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

**13. Pension Plan (continued)**

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Equity | 58% | 3.90% |
| Fixed income | 25 | 0.93 |
| Commodities | 2 | 0.08 |
| Real estate | 10 | 0.42 |
| Multi-asset class | 5 | 0.17 |
| Total | 100% | 5.50 |
| Inflation | | 3.25 |
| Expected arithmetic nominal return | | 8.75% |

*Discount Rate*

The discount rate used to measure the total pension liability was 8%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate, contributions from the District will be made at contractually required rates (actuarially determined), and contributions from the participating employers will be made at current statutorily required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

## 13. Pension Plan (continued)

*Sensitivity of the District's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate*

The following presents the District's proportionate share of the net pension liability using the discount rate of 8%, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7%) or 1-percentage-point higher (9%) than the current rate:

| | **1-Point Decrease (7%)** | **Discount Rate (8%)** | **1-Point Increase (9%)** |
|---|---|---|---|
| District's proportionate share of the net pension liability | $ 433,446,288 | $ 339,937,627 | $ 264,964,121 |

*Pension Plan Fiduciary Net Position*

Detailed information about the pension plan's fiduciary net position is available in the separately issued ASRS Comprehensive Annual Financial Report.

## 14. Commitments and Contingencies

### Operating Leases

The District leases various equipment and facilities under operating leases expiring at various dates through June 2020. Total rental expense in 2017 and 2016 for all operating leases was $3,789,722 and $3,417,068, respectively.

The following is a schedule, by year, of future minimum lease payments under operating leases as of June 30, 2017 that have initial or remaining noncancelable lease terms in excess of one year:

| | |
|---|---|
| Year ending June 30: | |
| 2018 | $ 2,330,027 |
| 2019 | 2,238,372 |
| 2020 | 1,778,784 |
| 2021 | 1,547,089 |
| 2022 | 1,396,451 |

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

**Litigation**

In the normal course of business, the District is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the County's risk management program (see Note 1) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The District evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each allegation. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

**Maricopa Health Plan**

MHP's contract with AHCCCS requires the plan to be in compliance with certain financial and nonfinancial covenants as defined. At June 30, 2017, management believes MHP was in compliance with these covenants.

For 2017 and 2016, substantially all of MHP's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS program is dependent upon governmental policies. This contract is subject to periodic renewal. MHP was awarded its AHCCCS contract renewal through January 31, 2017.

The District has secured an irrevocable letter of credit in the amount of $25,000,000 with Travelers Casualty and Surety Company of America to fulfill the performance bond requirement of the AHCCCS contract at June 30, 2017.

**Maricopa Care Advantage**

During the year ended June 30, 2016, the District was awarded a contract with AHCCCS for a Medicare Advantage Special Needs Program (SNP). The new SNP plan, Maricopa Care Advantage, or MCA, began enrolling members on January 1, 2014.

MCA's contract with AHCCCS requires the plan to be in compliance with certain financial and nonfinancial covenants as defined. At June 30, 2017, management believes MCA was in compliance with these covenants.

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

For 2017 and 2016, substantially all of MCA's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS program is dependent upon governmental policies. This contract is subject to periodic renewal. MCA was awarded its AHCCCS contract renewal through December 31, 2016.

The District has secured an irrevocable letter of credit in the amount of $2,500,000 with Travelers Casualty and Surety Company of America to fulfill the performance bond requirement of the AHCCCS contract at June 30, 2017.

**15. Disproportionate Share Settlement**

Section 1923 of the Social Security Act establishes federal requirements designed to aid entities that provide medical services to a disproportionate share of medically indigent patients. These requirements were met for the state fiscal years ended June 30, 2017 and 2016, through disproportionate share settlements established in Laws 2016 Second Regular Session Chapter 122 and Laws 2015 First Regular Session Chapter 14. AHCCCS was directed to distribute such settlements based on various qualifying criteria and allocation processes. The District recorded in other operating revenue approximately $5,672,000 and $4,202,000 in disproportionate share settlements in fiscal years 2017 and 2016, respectively.

**16. Related-Party Transactions**

During the years ended June 30, 2017 and 2016, net patient service revenues included approximately $4,534,000 and $3,690,000, respectively, of payments received from Maricopa County Correctional Health for medical services rendered, and approximately $2,544,000 and $2,700,000 in grant funds were received from the Maricopa County Department of Public Health in fiscal years 2017 and 2016, respectively.

During the years ended June 30, 2017 and 2016, net patient revenues also included approximately $44,228,000 and $38,753,000, respectively, of payments received from MMIC for medical and behavioral services rendered.

**17. Subsequent Events**

Subsequent events were evaluated through December 15, 2017, the date the accompanying financial statements were available to be issued.

Effective July 1, 2017, the District elected to levy a secondary property tax on all taxable property in the defined surrounding area at the rate necessary to generate approximately $73,821,000 of annual tax revenue. The tax revenue is to be used to support operations of the District.

Effective July 1, 2017, the District elected to levy property tax on all taxable property in the defined surrounding area, in the amounts of $34,227,000 and $964,000 for the third year principal and interest debt service, respectively, on the general obligation bonds.

On August 23, 2017, the Maricopa County Special Health Care District Board unanimously voted to create a new academic partnership between MIHS, Dignity Health St. Joseph's Hospital, District Medical Group (DMG) and Creighton University School of Medicine. The Creighton University Arizona Health Education Alliance (the Alliance) is designed to improve and expand current health education programs offered by MIHS and the other entities. The Alliance also will develop new academic and clinical education programs in medicine, nursing, pharmacy and allied health. Starting July 1, 2018, MIHS' and Dignity Health St. Joseph's Hospital Graduate Medical Education programs will be transferred to the Alliance. In addition, Creighton University, along with the Alliance partners, has an accelerated nursing program, which has received state approval. The nursing program is scheduled to begin January 2018.

On September 27, 2017, the District Board of Directors voted unanimously to expand MIHS' healthcare services with the construction of the West Valley Primary and Specialty Center in Peoria, AZ. The new facility will sit on roughly 20 acres and have approximately 127,000 square feet for a total project cost of nearly $70 million. On December 8, 2017, the District completed the purchase of the land for the new West Valley Primary and Specialty Center in the amount of $5.7 million.

On October 12, 2017, the District closed its second offering of general obligation bonds in the amount of $75,000,000 to continue its various improvement projects on its existing outpatient health centers and behavioral health facilities and start the construction of the West Valley Primary and Specialty Center.

# Schedules of Required Supplementary Information

# Maricopa County Special Health Care District
# d/b/a Maricopa Integrated Health System

## Schedule of District's Proportionate Share of the Net Pension Liability

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| District's proportion of the net pension liability | **2.11%** | 2.15% | 2.25% |
| District's proportionate share of the net pension liability | **$ 339,937,627** | $ 334,641,881 | $ 332,820,645 |
| District's covered-employee payroll | **$ 188,850,966** | $ 195,634,317 | $ 196,475,917 |
| District's proportionate share of the net pension liability as a percentage of its covered-employee payroll | **180.00%** | 171.05% | 169.40% |
| Plan fiduciary net position as a percentage of the total pension liability | **67.06%** | 68.35% | 69.49% |

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

## Schedule of Contributions

| | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Contractually required contribution | **$ 21,415,734** | $ 22,204,669 | $ 22,555,661 | $ 23,051,013 | $ 21,983,276 | $ 20,313,930 | $ 17,638,686 | $ 16,841,546 | $ 16,979,093 | $ 16,457,113 | $ 13,667,981 |
| Contributions in relation to the contractually required contribution | **(23,314,715)** | (22,366,096) | (22,849,862) | (21,695,216) | (22,325,937) | (20,633,465) | (18,011,420) | (16,725,499) | (17,077,783) | (16,695,527) | (13,846,083) |
| Contribution (excess) deficiency | **$ (1,898,981)** | **$ (161,427)** | $ (294,201) | $ 1,355,797 | $ (342,661) | $ (319,535) | $ (372,734) | $ 116,047 | $ (98,690) | $ (238,414) | $ (178,102) |
| District's covered-employee payroll | **$ 188,850,966** | $ 195,634,317 | $ 196,475,917 | $ 203,989,176 | $ 201,678,461 | $ 193,644,075 | $ 183,733,181 | $ 187,120,954 | $ 189,701,783 | $ 180,838,429 | $ 158,920,291 |
| Contributions as a percentage of covered-employee payroll | **11.34%** | 11.35% | 11.48% | 11.30% | 10.90% | 10.49% | 9.60% | 9.00% | 8.95% | 9.10% | 8.60% |

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# Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Management and the Board of Directors
Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 15, 2017.

## Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control described in the accompanying Schedule of Findings and Responses (2017-001) that we consider to be material weaknesses.

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**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

**The District's Response to Findings**

The District's response to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses (2017-001). The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

December 15, 2017

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Schedule of Findings

For the Year Ended June 30, 2017

**Section I – Summary of Auditor's Results**

**Financial Statements**

| | | |
|---|---|---|
| Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP (*unmodified, qualified, adverse or disclaimer*) | **Unmodified** | |
| Internal control over financial reporting: | | |
| Material weakness(es) identified? | X **Yes** | **No** |
| Significant deficiency(ies) identified? | **Yes** | X **None reported** |
| Noncompliance material to financial statements noted? | **Yes** | X **No** |

**Section II – Financial Statement Findings**

This section should identify the significant deficiencies, material weaknesses, fraud, noncompliance with provisions of laws, regulations, contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* requires reporting.

During our audit, we noted the following matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

*Criteria or specific requirement:*
Valuation of accounts receivable

*Condition:*
During our testing of the contractual allowance models, three clerical errors were identified that resulted in adjustments greater than the nominal amount.

**Section II – Financial Statement Findings (continued)**

*Context:*
The contractual allowance model calculations are prepared manually, which makes them more susceptible to errors that can go undetected without sufficient review. We identified two errors that were clerical in nature. In the mental health model, we noted patient accounts were included multiple times within the model, which resulted in an overstatement of the related contractual allowance. In the outpatient model, we noted patient accounts that were excluded from the model, which resulted in an understatement of the related contractual allowance.

*Effect:*
The overstatement of contractual allowance related to the mental health model was approximately $7,000,000. The understatement of the contractual allowance related to the outpatient model was approximately $1,600,000.

*Cause:*
The review performed by management over the contractual allowance model and underlying calculations was not sufficient to detect the errors.

*Recommendation:*
We recommend that management revise the review process of the allowance model to ensure that the review is sufficient to detect material misstatements on a timely basis. As a part of the review, data used in the calculation should be verified for completeness and accuracy. Additionally, the clerical accuracy should be tested to verify the integrity of the model. The resulting allowances should be reviewed to ensure that the allowances are reasonable compared to the accounts receivable balance, historical allowances, and changes in the business.

*Views of responsible officials and planned corrective actions:*
Management acknowledges this finding and will address remediation in the accompanying corrective action plan.

*Conclusion:*
Accounts receivable and net revenue were understated by $5,400,000 and have been adjusted.

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MIHS Management Response – Finding 2017-01

*Management Response*

Management is instituting an internal control that is sufficient to detect material misstatement of the allowance model on a timely basis. Specifically, the detailed allowance worksheets will be reconciled to the Aged Trial Balance reports by the Assistant Controller and the Controller on a monthly basis. Management is also contracting with an independent outside firm to assist with the analysis and computation of both the allowance and bad debt models. We anticipate to have this new process in place by January 2018 at the earliest. On a monthly basis, MIHS and this firm will jointly review the resulting allowances to ensure that they are reasonable compared to the accounts receivable balance, historical allowances, and changes in the business.