SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION dba MERCY CARE PLAN

FINANCIAL STATEMENTS

Years Ended June 30, 2011 and 2010

SOUTHWEST CATHOLIC
HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

FINANCIAL STATEMENTS

Years Ended June 30, 2011 and 2010

CONTENTS

MHM

Mayer Hoffman McCann P.C.

An Independent CPA Firm

3101 North Central Avenue, Suite 300
Phoenix, Arizona 85012
602-264-6835 ph
602-265-7631 fx
www.mhm-pc.com

INDEPENDENT AUDITORS' REPORT

The Board of Directors

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

We have audited the accompanying statements of financial position of ***Southwest Catholic Health Network Corporation (SCHN) dba Mercy Care Plan*** as of June 30, 2011 and 2010, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of SCHN's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SCHN's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ***Southwest Catholic Health Network Corporation dba Mercy Care Plan*** at June 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Mayer Hoffman McCann P.C.

Phoenix, Arizona
October 5, 2011

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

STATEMENTS OF FINANCIAL POSITION

June 30, 2011 and 2010
(In thousands)

A S S E T S

	2011	2010
CURRENT ASSETS		
Cash and cash equivalents	$ 144,696	$ 36,613
Short-term investments	36,604	31,738
Receivables:		
Reinsurance receivables, net of allowance for doubtful accounts of $6,922 for 2011 and $6,700 for 2010	41,549	45,416
Reconciliation receivables	8,042	1,857
Capitation and supplement receivables	17,575	111,499
Pharmacy receivable	2,414	5,333
Third party liability receivable, net of allowance for doubtful accounts of $1,183 for 2011 and $1,639 for 2010	5,966	5,242
Interest receivable	957	1,026
Provider advances, net of allowance for doubtful accounts of $1,100 for 2011 and $3,232 for 2010	13,103	13,892
Prepaid assets	247	302
TOTAL CURRENT ASSETS	271,153	252,918
RECONCILIATION RECEIVABLES, less current portion	3,272	9,174
RISK SHARE SETTLEMENT	1,101	-
LONG-TERM INVESTMENTS	159,224	143,948
TOTAL ASSETS	$ 434,750	$ 406,040

L I A B I L I T I E S A N D N E T A S S E T S

	2011	2010
CURRENT LIABILITIES		
Medical claims payable	$ 166,187	$ 165,847
Reconciliation payable	51,263	30,245
Due to Aetna	11,793	9,610
Other current liabilities	8,326	8,954
Current portion of risk share settlement	9,068	8,794
TOTAL CURRENT LIABILITIES	246,637	223,450
RISK SHARE SETTLEMENT, less current portion	-	3,801
TOTAL LIABILITIES	246,637	227,251
UNRESTRICTED NET ASSETS	188,113	178,789
TOTAL LIABILITIES AND NET ASSETS	$ 434,750	$ 406,040

See Notes to Financial Statements

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2011 and 2010
(In thousands)

	2011	2010
OPERATING REVENUES		
Capitation premiums	$ 1,764,251	$ 1,750,431
Delivery/HIV-AIDS supplement	61,932	62,577
Reinsurance	98,873	75,954
Other, primarily third party recoveries	5,423	7,197
TOTAL OPERATING REVENUES	1,930,479	1,896,159
HEALTH CARE EXPENSES		
Hospitalization	452,510	440,221
Medical compensation	349,012	338,461
Ancillary and other medical services	669,845	669,989
Institutional	120,810	122,236
Home and community based services	112,294	109,905
TOTAL HEALTH CARE EXPENSES	1,704,471	1,680,812
GENERAL AND ADMINISTRATIVE EXPENSES	145,451	138,504
PREMIUM TAX EXPENSE	32,209	33,577
TOTAL EXPENSES	1,882,131	1,852,893
OPERATING INCOME	48,348	43,266
NONOPERATING INCOME (EXPENSE)		
Investment income	10,287	8,826
Investment fees	(947)	(832)
TOTAL NONOPERATING INCOME	9,340	7,994
EXCESS OF REVENUE OVER EXPENSES	57,688	51,260
REALIZED GAIN ON SETTLEMENT OF PENSION PLAN	579	-
NET UNRECOGNIZED LOSS ON PENSION PLAN	-	(2,228)
CHANGE IN NET ASSETS PRIOR TO UNREALIZED GAINS ON INVESTMENTS	58,267	49,032
UNREALIZED GAINS ON INVESTMENTS	11,057	5,112
CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS	69,324	54,144
DISTRIBUTIONS TO SPONSOR ORGANIZATIONS	(60,000)	-
CHANGE IN NET ASSETS	9,324	54,144
NET ASSETS, BEGINNING OF YEAR	178,789	124,645
NET ASSETS, END OF YEAR	$ 188,113	$ 178,789

See Notes to Financial Statements

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2011 and 2010
(In thousands)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets prior to distributions	$ 69,324	$ 54,144
Adjustments to reconcile change in net assets prior to distributions to net cash provided by operating activities:		
Pension asset	-	443
Bad debt expense	18,414	10,593
Net unrealized gains on investments	(11,057)	(5,112)
Net realized gains on investments	(4,762)	(3,902)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Reinsurance receivables	4,021	31,191
Reconciliation receivables	(20,983)	31,412
Capitation and supplement receivables	93,924	(77,587)
Pharmacy receivable	2,919	(1,310)
Third party liability receivable	(724)	(131)
Interest receivable	69	(220)
Provider advances	2,921	9,113
Due from Aetna	-	222
Prepaid assets	55	2,937
Increase (decrease) in:		
Medical claims payable	340	(53,246)
Reconciliation payable	21,018	30,245
Due to Aetna	2,183	9,610
Other current liabilities	(628)	7,140
Risk share settlement	(4,628)	7,255
Net cash provided by operating activities	172,406	52,797
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(135,712)	(124,547)
Proceeds from sale of investments	131,389	97,880
Net cash used in investing activities	(4,323)	(26,667)
CASH FLOWS FROM FINANCING ACTIVITIES		
Distributions to sponsor organizations	(60,000)	-
Net cash used in financing activities	(60,000)	-
NET CHANGE IN CASH AND CASH EQUIVALENTS	108,083	26,130
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	36,613	10,483
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 144,696	$ 36,613

See Notes to Financial Statements

(1) Company operations and significant accounting policies

Company operations - Southwest Catholic Health Network Corporation dba Mercy Care Plan (SCHN, or the Plan) is a nonprofit corporation, whose sponsor organizations are Catholic Healthcare West (CHW) and Carondelet Health Network (Carondelet), collectively the "sponsors." SCHN provides medical care under various contracts with the Arizona Health Care Cost Containment System (AHCCCS), a department of the state of Arizona charged with administering health care for the state's indigent population. SCHN provides medical coverage under the AHCCCS contract for the following populations:

- AHCCCS Acute - Acute members eligible under Title XIX Medicaid program and Title XXI program requirements
- Arizona Long Term Care System (ALTCS) - Provide institutional care, home and community based services and behavioral health services to the long term care members
- AHCCCS Healthcare Group (HCG) - Provide coverage primarily to small businesses

SCHN also provides medical care to qualified members through a contract with the Arizona Department of Economic Security, Division of Developmental Disabilities (DES/DDD).

SCHN operates a Medicare Advantage Plan (Medicare Advantage) with the Centers for Medicare and Medicaid Services (CMS), offering medical and prescription drug benefits to qualified members. Medicare Advantage operates as a special needs plan under CMS guidelines. The populations covered under Medicare Advantage are members who are eligible for both Medicare and Medicaid coverage. Virtually all of the members of Medicare Advantage receive their Medicaid benefits through one of SCHN's AHCCCS contracts.

SCHN has entered into a management agreement with Aetna through June 30, 2012, which automatically renews for successive one-year periods. Under the terms of the agreement, SCHN pays a monthly fee to Aetna, as defined in the agreement, to cover the employee salary and benefit costs and general and administrative expenses incurred to operate the Plan. SCHN paid management fees per the agreement of approximately $142,193,000 and $134,230,000 for the years ended June 30, 2011 and 2010, respectively.

The Financial Accounting Standards Board ("FASB") sets U.S. generally accepted accounting principles ("GAAP") to ensure consistent reporting. References to GAAP are to the FASB Accounting Standards Codification ("FASB ASC").

A summary of the Plan's significant accounting policies follows:

Basis of presentation - The accompanying financial statements have been prepared in accordance with FASB ASC 954-205, *Health Care Entities – Presentation of Financial Statements*. SCHN's financial statements are also presented in accordance with FASB ASC 958-205, *Not-for-Profit Entities – Presentation of Financial Statements.* Under FASB ASC 958-205, SCHN is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. As of June 30, 2011 and 2010, there were no temporarily restricted or permanently restricted net assets.

(1) Company operations and significant accounting policies (continued)

Capitation premiums - The Plan receives from AHCCCS and CMS fixed capitation payments, generally in advance, based on certain rates for each member enrolled with the Plan. The Plan is required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the Plan retains the funds as profit; if the costs are higher than the amount of capitation payments from AHCCCS and CMS, the Plan absorbs the loss. Capitation premiums are recognized in the month that enrollees are entitled to health care services. Certain provisions of the AHCCCS Acute, HCG, DDD and ALTCS contracts include a risk band whereby SCHN and the AHCCCS programs share in the profits and losses of the contract, as defined in the respective contracts (reconciliation revenue). SCHN has recorded an estimate of the reconciliation revenue, within capitation premiums, based on the operational performance of the AHCCCS Acute, HCG, DDD and ALTCS lines of business. The Plan may recover certain losses for those cases eligible for reinsurance payments. Medicare Advantage capitation premiums received in the month prior to enrollee coverage are deferred and recognized in revenue in the succeeding month.

Capitation is paid prospectively as well as for prior period coverage (PPC). The PPC period is from the first day of the month of member's application to the time of enrollment with a contracted health plan. The risk under PPC is shared by both the Plan and AHCCCS for the contract year ending September 30, 2011. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the contract year.

The Plan shares risk with AHCCCS and DES/DDD for specific populations as follows:

- Title XIX Waiver Group Prospective
- Acute Prior Period Coverage
- ALTCS Prior Period Coverage
- DDD
- Health Care Group Risk Based Performance
- Home and Community Based Services
- Share of Cost

Reconciliation balances are stated at the amount management expects to collect or pay. As of June 30, 2011, the Plan recorded a reconciliation receivable of $11,314,000 and a reconciliation payable of $51,263,000. As of June 30, 2010, the Plan recorded a reconciliation receivable of $11,031,000 and a reconciliation payable of $30,245,000. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to reconciliation receivables. At June 30, 2011 and 2010, reconciliation receivables were net of an allowance for doubtful accounts of approximately $0 for each year.

Delivery supplemental revenue - Delivery supplemental revenue is reimbursement from AHCCCS intended to cover the expenses related to deliveries. Such premiums are recognized in the month that services are rendered. The Plan earned approximately $61,912,000 and $62,568,000 of this supplemental revenue in fiscal 2011 and 2010, respectively.

(1) Company operations and significant accounting policies (continued)

HIV-AIDS supplemental revenue - HIV-AIDS supplemental revenue is reimbursement DDD intended to help defray the costs of HIV/AIDS drugs. Such premiums are recognized in the month that services are rendered. The Plan earned approximately $20,000 and $9,000 of this supplemental revenue in fiscal 2011 and 2010, respectively.

Reinsurance revenue - AHCCCS and DES/DDD provide a stop-loss reinsurance program for the Plan for partial reimbursement of reinsurable covered medical services incurred for members. The program includes a deductible, which varies based on the Plan's enrollment and the eligibility category of the members. AHCCCS and DES/DDD reimburse the Plan based on a coinsurance amount for reinsurable covered services incurred above the deductible. SCHN contracts with a commercial reinsurer to provide reinsurance for the Medicare Advantage Plan. Reinsurance revenue is stated at the actual and estimated amounts due to SCHN pursuant to the AHCCCS Acute, DES/DDD, HCG, ALTCS and Medicare Advantage Plan contracts. Below are the reinsurance thresholds by line of business:

Line of Business	Annual Deductible Effective October 1, 2010	Annual Deductible Effective October 1, 2009	Coinsurance
AHCCCS Acute – Prospective Only	$ 20,000	$ 20,000	75%
Title XIX Waiver Group – Prospective Only	20,000	20,000	75
DES/DDD	20,000	20,000	75
DES/DDD Ventilator Dependent	No deductible	No deductible	100
ALTCS w/Medicare	20,000	20,000	75
ALTCS w/o Medicare	30,000	30,000	75

Line of Business	Annual Deductible Effective July 1, 2010	Annual Deductible Effective July 1, 2009	Coinsurance
HCG – Effective July 1, 2010 and 2009	$ 165,000	$ 135,000	90%

Line of Business	Annual Deductible Effective January 1, 2011	Annual Deductible Effective January 1, 2010	Coinsurance
Medicare Advantage – effective January 1, 2011 and 2010	$ 500,000	$ 300,000	90%

To be eligible for reinsurance billing, qualified healthcare expenses must be incurred during the contract year. Reinsurance revenue is recorded based on actual billed reinsurance claims adjusted for medical cost completion factors and SCHN's historical collection experience. Reinsurance revenue is subject to review by AHCCCS and DES/DDD, and as a result, there is at least a reasonable possibility that recorded reinsurance revenue will change by a material amount in the near future.

(1) Company operations and significant accounting policies (continued)

Reinsurance receivable is the expected payment from AHCCCS and DES/DDD to the Plan for certain enrollees whose qualifying medical expenses paid by the Plan were in excess of specified deductible limits. Reinsurance receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to reinsurance receivable. At June 30, 2011 and 2010, reinsurance receivable was net of an allowance for doubtful accounts of approximately $6,922,000 and $6,700,000, respectively.

Cash and cash equivalents - Cash includes cash deposits in banks and cash equivalents. SCHN considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Amounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC).

Pharmacy receivable - SCHN receives rebates from pharmaceutical companies based on the volume of drugs purchased. SCHN records a receivable and a reduction of medical expenses for estimated rebates due based on purchase information. During the years ended June 30, 2011 and 2010, medical expenses were reduced by approximately $8,220,000 and $11,127,000 of rebates, respectively. Effective January 2011, AHCCCS implemented a drug rebate program and is now receiving the rebates generated from the AHCCCS lines of business directly. At June 30, 2011 and 2010, management believes these receivables are fully collectible and accordingly, an allowance has not been established.

Third party liability receivable - In cases such as motor vehicle accidents and worker's compensation claims, a third party insurer may be liable for a claim. When SCHN pays claims on behalf of its members and determines a third party insurance company is ultimately responsible for that claim, it estimates a receivable and recoups the claim cost from the third party insurer. Third party liability receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to third party liability receivable. At June 30, 2011 and 2010, third party liability receivable was net of an allowance for doubtful accounts of approximately $1,183,000 and $1,639,000, respectively.

Provider advances - Upon request, SCHN may advance monies to high-volume providers based on cash flow needs and timing of claims payments. Advances are stated at the amount management expects to collect or offset against future claims. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to provider advances receivable. At June 30, 2011 and 2010, provider advance receivables were net of an allowance for doubtful accounts of approximately $1,100,000 and $3,232,000, respectively.

Investments - Investments are recorded in accordance with FASB ASC 958-320, *Investments-Debt and Equity Securities* and FASB ASC 958-325, *Not-for-Profit Entities Investments – Other*. Under FASB ASC 958-320 and FASB ASC 958-325, SCHN reports investments in equity securities that have readily determinable fair values, and all investments in debt securities at fair value based on quoted market prices. Investment securities without quoted market prices are valued at estimated fair value using appropriate valuation methods that consider the underlying assets. SCHN's investment portfolio is managed by professional investment managers within guidelines established by SCHN's Board of Directors which, as a matter of policy, limits the amounts which may be invested in any one issuer or type of investment.

(1) Company operations and significant accounting policies (continued)

Investment securities in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the near term could materially affect account balances and the amounts reported in the accompanying financial statements.

Investment income - Investment income consists of interest, dividends, and realized gains and losses on investments. Interest is recognized on the accrual basis, and dividends are recorded as earned on the ex-dividend date. Interest income on mortgage- and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Accrual of income is suspended for bonds and mortgage loans that are in default or when the receipt of interest payments is in doubt. SCHN has a policy to review and identify investments with declines in value that would be considered to be other-than-temporary. Such other-than-temporary declines, if significant, are accounted for as realized losses (See Note 3).

Risk share settlement - The risk share settlement represents expected payments to be paid to or received from CMS in connection with the pharmacy component of Medicare Advantage. This balance is reviewed and monitored by management and adjusted as necessary as experience develops or new information becomes available. Such adjustments are netted against the capitation premiums on the statements of activities and changes in net assets. The pharmacy risk share settlement for calendar year 2011 and 2010, recorded at June 30, 2011, is expected to be finalized in late 2012 and 2011, respectively.

Health Care Group - medical loss ratio reconciliation - Effective January 1, 2011, HCG issued an amendment to its contract to include a provision for application of Plan operating profits over six percent (6%) to any outstanding reconciliation receivable balance. If the annual operating profit for SCHN exceeds six percent (6%), the amount in excess shall be applied to reduce the reconciliation receivable balance. The amount used to reduce the reconciliation receivable balance for fiscal 2011 was $1,301,641.

Premium deficiency reserve - SCHN evaluates possible losses on its contracts through the end of each contract year. If necessary, a premium deficiency reserve is recorded within medical claims payable on the statement of financial position. As of June 30, 2011 and 2010, no premium deficiency reserve was considered necessary.

Healthcare service cost recognition - The costs of providing hospitalization, medical compensation, ancillary and other medical services, institutional, and home and community based services are accrued in the period in which the service is provided to eligible recipients based in part on estimates, including an accrual for services incurred but not yet reported to SCHN.

The estimate for unreported services payable is developed using actuarial methods based on historical experience and are continually reviewed by management and adjusted as necessary based on current claims data, and medical cost completion factors. Such adjustments are included in health care expenses in the statements of activities and changes in net assets in each period when necessary. While management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. There is at least a reasonable possibility that the recorded estimates will change by a material amount, in the near future.

(1) Company operations and significant accounting policies (continued)

Management's use of estimates - The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include reconciliation receivables/payables, risk share settlements, the allowances for doubtful accounts and the estimate for medical claims payable.

Premium taxes - SCHN is subject to a 2% tax on all payments received from AHCCCS for premiums, reinsurance, and reconciliations.

Income taxes - Southwest Catholic Health Network Corporation dba Mercy Care Plan qualifies as a tax exempt organization under Section 501(c)(3) of the Internal Revenue Code (the "Code") and, therefore, there is no provision for income taxes included in the accompanying financial statements. Income determined to be unrelated business taxable income (UBTI) would be taxable.

FASB ASC 740-10, *Income Taxes*, relates to the accounting for uncertainty income taxes which requires the application of a "more likely than not" threshold recognition and de-recognition of uncertain tax positions in operations in the year of such change. SCHN evaluates their uncertain tax positions, if any, on a continual basis through review of their policies and procedures, review of their regular tax flings, and discussions with outside experts. At June 30, 2011 and 2010, SCHN did not have any uncertain tax positions.

SCHN's Federal Exempt Organization Business Income Tax Returns (Form 990) for 2008, 2009, and 2010 are subject to examination by the IRS, generally for the three years after they were filed.

Performance indicator - The statement of activities includes the performance indicator operating income. The performance indicator excludes nonoperating income (expense), net unrealized investment gains (losses), gain on settlement of pension plan, and net unrecognized loss on pension plan, which is consistent with industry practice.

Subsequent events - SCHN has evaluated subsequent events through October 5, 2011, which is the date the financial statements were available to be issued. See Note 9 for contract extensions. No other subsequent events requiring disclosure were identified.

(2) Reconciliation

Reconciliation balances are recorded as a net receivable or payable on the statement of financial position by line of business. HCG is recorded as a short term/long term receivable. During fiscal 2011, the Acute reconciliation balance shifted from a receivable in fiscal 2010 to a payable in fiscal 2011 due to contract profit limitations. At June 30, 2011, reconciliation receivables are considered to be collectible in full; therefore, an allowance for doubtful accounts is not considered necessary. A summary of the balances by line of business for the years ended June 30 are as follows (in thousands):

	2011		2010	
	Reconciliation Receivable	Reconciliation Payable	Reconciliation Receivable	Reconciliation Payable
Acute	$ 3,215	$ 45,201	$ -	$ 29,030
ALTCS	1,564	264	1,107	-
DDD	-	5,798	-	1,215
HCG	6,535	-	9,924	-
	11,314	51,263	11,031	30,245
Allowance for doubtful accounts	-	-	-	-
	$ 11,314	$ 51,263	$ 11,031	$ 30,245

Amounts expected to be collected from HCG are as follows (in thousands):

2012	$ 3,263
2013	1,131
2014	1,131
2015	1,010
Total	$ 6,535

(3) Investments

The cost and fair value of SCHN's investments by type at June 30 are as follows (in thousands):

	2011		2010	
	Cost	Fair Value	Cost	Fair Value
Short-term:				
Marketable equity securities	$ 24,214	$ 24,214	$ 23,429	$ 23,429
Corporate bonds	8,293	8,167	5,183	5,129
U.S. Government securities	4,370	4,223	3,323	3,180
	36,877	36,604	31,935	31,738
Long-term:				
Marketable equity securities	62,193	71,941	59,334	57,822
U.S. Government securities	9,529	9,684	7,223	7,268
Corporate bonds	57,588	59,504	62,405	64,460
Mortgage-backed securities	16,042	16,354	10,169	10,721
Preferred securities	1,551	1,741	3,626	3,677
	146,903	159,224	142,757	143,948
	$ 183,780	$ 195,828	$ 174,692	$ 175,686

(3) Investments (continued)

Investment income for the years ended June 30 is comprised of the following (in thousands):

	2011	2010
Revenue (included in nonoperating investment income):		
Interest and dividend income	$ 5,525	$ 4,924
Realized gains on investments	4,762	3,902
	$ 10,287	$ 8,826

Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors and the length of time and extent to which the market value has been less than cost. During the years ended June 30, 2011 and 2010, SCHN recorded no losses for other-than-temporary declines in the fair value of investments.

The following table summarizes the unrealized losses on investments held at June 30, 2011 (in thousands):

	Less than twelve months		Twelve months or longer		Total	
Description of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government securities	$ 4,223	$ 148	$ 2,396	$ 6	$ 6,619	$ 154
Marketable equity securities	-	-	16,590	1,798	16,590	1,798
Corporate bonds	5,115	163	24,050	338	29,165	501
Mortgage-backed securities	-	-	5,870	23	5,870	23
Preferred securities	-	-	-	-	-	-
Total	$ 9,338	$ 311	$ 48,906	$ 2,165	$ 58,244	$ 2,476

The following table summarizes the unrealized losses on investments held at June 30, 2010 (in thousands):

	Less than twelve months		Twelve months or longer		Total	
Description of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government securities	$ 3,179	$ 144	$ 2,306	$ 54	$ 5,485	$ 198
Marketable equity securities	-	-	33,590	5,998	33,590	5,998
Corporate bonds	3,731	94	17,594	193	21,325	287
Mortgage-backed securities	-	-	236	12	236	12
Preferred securities	-	-	-	-	-	-
Total	$ 6,910	$ 238	$ 53,726	$ 6,257	$ 60,636	$ 6,495

(3) Investments (continued)

Long-term investments can be liquidated without significant penalty within twenty-four hours, and are considered short-term for purposes of calculating current ratios under AHCCCS reporting guidelines.

Subsequent to June 30, 2011, the investment markets experienced significant declines in value. The declines and fluctuations had a direct impact on the investment portfolio of SCHN. For the period July 1, 2011 through August 31, 2011, SCHN incurred approximately $6.5 million of unrealized losses due to market declines.

(4) Fair value measurements

FASB ASC 820, *Fair Value Measurements and Disclosures,* establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. FASB ASC 820 establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The following table sets forth by level, within the fair value hierarchy, SCHN's investments at fair value as of June 30, 2011 (in thousands):

	(Level 1)	(Level 2)	(Level 3)	Total
U.S. government securities	$ 13,906	$ -	$ -	$ 13,906
Marketable equity securities				
U.S. large cap	70,525	-	-	70,525
Emerging markets	1,415	-	-	1,415
Money market mutual funds	17,802	-	-	17,802
Other	6,413	-	-	6,413
Total marketable equity securities	96,155	-	-	96,155
Corporate bonds	67,672	-	-	67,672
Mortgage-backed securities	-	16,354	-	16,354
Preferred securities	1,741	-	-	1,741
Total	$ 179,474	$ 16,354	$ -	$ 195,828

(4) Fair value measurements (continued)

The following table sets forth by level, within the fair value hierarchy, SCHN's investments at fair value as of June 30, 2010 (in thousands):

	(Level 1)	(Level 2)	(Level 3)	Total
U.S. government securities	$ 10,448	$ -	$ -	$ 10,448
Marketable equity securities				
U.S. large cap	54,037	-	-	54,037
U.S. mid cap/small cap	602	-	-	602
Emerging markets	2,185	-	-	2,185
Non U.S. equity	998	-	-	998
Money market mutual funds	17,773	-	-	17,773
Other	5,656	-	-	5,656
Total marketable equity securities	81,251	-	-	81,251
Corporate bonds	69,589	-	-	69,589
Mortgage-backed securities	-	10,721	-	10,721
Preferred securities	3,677	-	-	3,677
Total	$ 164,965	$ 10,721	$ -	$ 175,686

(5) Medical claims payable

At June 30, 2011 and 2010, claims outstanding to third parties for health care services provided to members, including estimates for incurred but not reported claims, were approximately $166 million for both years. The balances at June 30, 2011 and 2010 were certified by an actuary. Activity in the liability for medical claims payable and health care expense for the years ended June 30, 2011 and 2010 is as follows (in thousands):

	2011	2010
Balance at July 1	$ 165,847	$ 219,093
Incurred related to:		
Current year	1,456,418	1,633,064
Prior years	(22,954)	(57,412)
Total incurred	1,433,464	1,575,652
Paid related to:		
Current year	(1,297,073)	(1,467,677)
Prior years	(136,051)	(161,221)
Total paid	(1,433,124)	(1,628,898)
Balance at June 30	$ 166,187	$ 165,847

Estimates for incurred claims are based on historical enrollment, cost trends, and consider operational changes. Future actual results will typically differ from the estimates. Differences could be due to factors such as an overall change in medical expenses per member or a change in client mix affecting medical costs due to the addition of new members.

(5) Medical claims payable (continued)

The liability for claims unpaid at June 30, 2010 exceeded the actual claims incurred related to fiscal year 2010 and prior by approximately $23 million or 14%. The liability for claims unpaid at June 30, 2009 exceeded the actual claims incurred related to fiscal year 2009 and prior by approximately $57 million or 26%. The primary drivers for favorable claim development include member mix changes, active cost and encounter management, lower than anticipated member utilization, a shift from more costly inpatient and re-admittance utilization to physician office visits, inpatient unit cost reductions related to state-mandated outlier reform, increased speed of claims processing, and an increased initiative to recoup provider overpayments. SCHN continues to incur claims for prior periods. The medical claims payable is adjusted each period end as more information becomes available.

Estimated third-party subrogation included as a reduction to medical and hospital expenses in the accompanying statements of activities and changes in net assets at June 30, 2011 and 2010 totaled approximately $5,860,000 and $5,016,000, respectively.

(6) Related party transactions

SCHN paid approximately $87,176,000 in 2011 and $98,556,000 in 2010 to CHW and approximately $19,781,000 in 2011 and $21,185,000 in 2010 to Carondelet for hospitalization and other medical services provided to its members. These balances include net prospective provider advance payments made to CHW and Carondelet. At June 30, 2011, provider advances to CHW and Carondelet amounted to approximately $8,959,000 and $1,080,000, respectively. At June 30, 2010 provider advances to CHW and Carondelet amounted to approximately $5,687,000 and $5,471,000, respectively. During the year ended June 30, 2011, SCHN made net asset distributions of $30,000,000 to both CHW and Carondelet. The distributions were approved by AHCCCS.

(7) Retirement benefits

SCHN had a noncontributory defined benefit pension plan (Pension Plan) covering all eligible employees. All employees were covered on the first day of the month coincident with the completion of one year of service. Pension Plan benefits were based on the employee's career compensation.

Effective May 31, 2002, the Pension Plan was frozen based on salaries earned through April 30, 2002. SCHN continued to make annual contributions to the defined benefit pension plan in amounts sufficient to meet the minimum funding requirements of the Employment Retirement Income Security Act (ERISA). In July 2006, the Board of Directors of SCHN voted to terminate the Pension Plan. On April 5, 2010, the IRS approved the termination of the SCHN Pension Plan. The Pension Plan was unfunded by approximately $1,772,000 as of June 30, 2010 which was accrued for in other current liabilities on the statement of financial position. In April 2011, SCHN purchased a non-participating single premium group annuity contract for approximately $4,656,000 from Prudential Insurance Company of America ("Prudential") to settle the Pension Plan. To facilitate the purchase, SCHN transferred the Pension Plan assets totaling approximately $3,590,000 and approximately $1,066,000 of cash to Prudential. As a result of the transaction, SCHN reduced the $1,772,000 unfunded Pension Plan liability in the other current liabilities on the statement of financial position and recognized a gain on the statement of activities and changes in net assets on the transaction of approximately $579,000 during the year ended June 30, 2011.

(7) Retirement benefits (continued)

SCHN used a measurement date of July 1 for the Pension Plan. The following table sets forth the Pension Plan funded status as provided by independent actuaries at July 1:

	2011	2010
	(In thousands)	
Projected benefit obligation	$ -	$ (5,645)
Fair value of plan assets	-	3,873
Funded status of the plan	$ -	$ (1,772)
Unrecognized net actuarial loss	$ -	$ 3,605
Components of net periodic benefit cost:		
Interest cost	$ -	$ 245
Expected return on plan assets	-	(306)
Recognized net actuarial loss	-	67
Total net periodic pension cost (gains)	$ -	$ 6
Employer contributions	$ -	$ 13
Benefits paid	$ -	$ 184

Weighted-average assumptions used to determine net periodic pension cost were as follows as of June 30:

	2011	2010
Discount rate	0%	4.00%
Expected return on plan assets	0%	8.00%

(8) Commitments and contingencies

Letters of credit - At June 30, 2011 and 2010, SCHN has irrevocable standby letters of credit to satisfy the AHCCCS Acute, DES/DDD and ALTCS general performance bond requirements. Total amounts available are $61,650,000 at June 30, 2011 and 2010. No draws have been made on the letters of credit as of June 30, 2011 and 2010. The letters of credit are collateralized by certain investments of SCHN totaling approximately $159,224,000. To meet Medicare requirements, SCHN has entered into demand note agreements dated January 1, 2006 with CHW and Carondelet which allows SCHN to draw, upon demand, up to a combined maximum amount of $10,000,000. There were no draws on the note agreements as of June 30, 2011 and 2010.

Line of credit - At June 30, 2010, SCHN had a temporary line of credit of $30,000,000 to offset potential cash flow shortfalls due to the delay of the June 2010 Acute capitation payment of approximately $105,000,000. The credit line term was for sixty (60) days beginning June 21, 2010 and matured on August 20, 2010. The line was not renewed. No draws were made on the credit line. As of June 30, 2011, SCHN had no temporary lines of credit.

Contract compliance - Under the terms of the AHCCCS and Medicare Advantage (MCA) contracts, SCHN is required to meet certain financial covenants for both AHCCCS and CMS products. As of June 30, 2011 and 2010, SCHN is in compliance with the AHCCCS covenants. At June 30, 2011 and 2010, SCHN meets the MCA financial covenants.

(8) Commitments and contingencies (continued)

Litigation - Periodically, SCHN is involved in litigation and claims arising in the normal course of operations. In the opinion of management based on consultation with legal counsel, losses, if any, from these matters are covered by insurance or are immaterial. Management believes that any resulting liability, if any, will not materially affect SCHN's financial position.

Healthcare regulation - The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that SCHN is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future reviews and interpretation as well as regulatory actions unknown or unasserted at this time.

Health reform legislation at both the federal and state levels continues to evolve. Changes continue to impact existing and future laws and rules. Such changes may impact the way the Plan does business, restrict revenue and enrollment growth in certain products and market segments, restrict premium growth rates for certain products and market segments, increase medical, administrative and capital costs, and expose the Plan to increased risk of loss or further liabilities. The Plan's operating results, financial position and cash flows could be adversely impacted by such changes.

AHCCCS enrollment freeze - Effective July 8, 2011, AHCCCS has placed an enrollment freeze on the childless adult population preventing any new members to enroll. Childless adult members enrolled prior to July 8, 2011 continuing to meet eligibility requirements will continue to receive coverage. As a result, the Plan's operating results, financial position and cash flows could be adversely impacted by such changes.

(9) Concentration of credit risk

Future contract awards are contingent upon the continuation of the AHCCCS Acute, DES/DDD, HCG, and ALTCS programs by the State of Arizona and SCHN's ability and desire to retain its status as a contractor under these programs. The AHCCCS Acute contract is effective through September 30, 2011, with two additional one year renewal options. The ALTCS contract will expire on September 30, 2011. Through a bid process, SCHN was awarded a contract effective October 1, 2011 through September 30, 2014, with two additional one year renewal options. The DES/DDD contract was renewed through September 30, 2011. The HCG contract is effective through December 31, 2012. The Medicare Advantage contract is renewed annually by CMS. Failure to renew these contracts could have a significant impact on operations.

ADDITIONAL INFORMATION

Mayer Hoffman McCann P.C.
An Independent CPA Firm

3101 North Central Avenue, Suite 300
Phoenix, Arizona 85012
602-264-6835 ph
602-265-7631 fx
www.mhm-pc.com

INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

The Board of Directors

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

We have audited the financial statements of ***Southwest Catholic Health Network Corporation dba Mercy Care Plan*** as of and for the years ended June 30, 2011 and 2010, and our report thereon dated October 5, 2011, which expressed an unqualified opinion on those financial statements, appears on page 1. Our audits were conducted for the purpose of forming an opinion on the 2011 and 2010 financial statements taken as a whole. The financial information on pages 19 and 20 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. generally accepted auditing standards. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Mayer Hoffman McCann P.C.

Phoenix, Arizona
October 5, 2011

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

SUPPLEMENTAL STATEMENT OF FINANCIAL POSITION

June 30, 2011
(In thousands)

A S S E T S

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
CURRENT ASSETS						
Cash and cash equivalents	$ 144,696	$ -	$ -	$ -	$ -	$ 144,696
Short-term investments	20,848	2,196	346	11,285	1,929	36,604
Receivables:						
Reinsurance receivables, net	27,829	1,097	-	12,119	504	41,549
Reconciliation receivables, net	3,215	(9)	3,263	1,573	-	8,042
Capitation and supplement receivables	1,665	-	-	27	15,883	17,575
Pharmacy receivable	-	-	-	-	2,414	2,414
Third party liability receivable, net	4,994	119	54	778	21	5,966
Interest receivable	546	57	9	295	50	957
Provider advances, net	8,817	285	310	547	3,144	13,103
Intercompany	(68,732)	1,977	(925)	48,062	19,618	-
Prepaid assets	247	-	-	-	-	247
TOTAL CURRENT ASSETS	144,125	5,722	3,057	74,686	43,563	271,153
RECONCILIATION RECEIVABLES, less current portion	-	-	3,272	-	-	3,272
RISK SHARE SETTLEMENT	-	-	-	-	1,101	1,101
LONG-TERM INVESTMENTS	90,686	9,549	1,507	49,091	8,391	159,224
TOTAL ASSETS	$ 234,811	$ 15,271	$ 7,836	$ 123,777	$ 53,055	$ 434,750

L I A B I L I T I E S A N D N E T A S S E T S

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
CURRENT LIABILITIES						
Medical claims payable	$ 103,856	$ 2,412	$ 1,139	$ 35,773	$ 23,007	$ 166,187
Reconciliation payable	45,201	5,798	-	264	-	51,263
Due to Aetna	7,519	55	37	2,077	2,105	11,793
Other current liabilities	4,528	(5)	7	2,217	1,579	8,326
Current portion of risk share settlement	-	-	-	-	9,068	9,068
TOTAL CURRENT LIABILITIES	161,104	8,260	1,183	40,331	35,759	246,637
RISK SHARE SETTLEMENT, less current portion	-	-	-	-	-	-
TOTAL LIABILITIES	161,104	8,260	1,183	40,331	35,759	246,637
UNRESTRICTED NET ASSETS	73,707	7,011	6,653	83,446	17,296	188,113
TOTAL LIABILITIES AND NET ASSETS	$ 234,811	$ 15,271	$ 7,836	$ 123,777	$ 53,055	$ 434,750

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

SUPPLEMENTAL STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2011
(In thousands)

	Acute	DES/DDD	HCG	ALTCS	Medicare	Total
OPERATING REVENUES						
Capitation premiums	$ 1,095,475	$ 33,634	$ 15,202	$ 330,340	$ 289,600	$ 1,764,251
Delivery/hospital/HIV-AIDS supplement	61,912	20	-	-	-	61,932
Reinsurance	67,679	2,170	122	28,398	504	98,873
Other, primarily third party recoveries	5,006	47	(474)	534	310	5,423
TOTAL OPERATING REVENUES	1,230,072	35,871	14,850	359,272	290,414	1,930,479
HEALTH CARE EXPENSES						
Hospitalization	321,683	6,837	2,898	23,602	97,490	452,510
Medical compensation	294,922	4,350	2,241	10,758	36,741	349,012
Ancillary and other medical services	474,927	22,865	6,412	46,863	118,778	669,845
Institutional	-	-	-	120,810	-	120,810
Home and community based services	-	-	-	112,294	-	112,294
TOTAL HEALTH CARE EXPENSES	1,091,532	34,052	11,551	314,327	253,009	1,704,471
GENERAL AND ADMINISTRATIVE EXPENSES	91,671	3,512	1,259	21,918	27,091	145,451
PREMIUM TAX EXPENSE	24,771	-	-	7,438	-	32,209
TOTAL EXPENSES	1,207,974	37,564	12,810	343,683	280,100	1,882,131
OPERATING INCOME (LOSS)	22,098	(1,693)	2,040	15,589	10,314	48,348
NONOPERATING INCOME (EXPENSE)						
Investment income	6,267	560	88	2,880	492	10,287
Investment fees	(947)	-	-	-	-	(947)
TOTAL NONOPERATING INCOME	5,320	560	88	2,880	492	9,340
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENSES	27,418	(1,133)	2,128	18,469	10,806	57,688
REALIZED GAIN ON SETTLEMENT OF PENSION PLAN	579	-	-	-	-	579
CHANGE IN NET ASSETS PRIOR TO UNREALIZED GAINS ON INVESTMENTS	27,997	(1,133)	2,128	18,469	10,806	58,267
UNREALIZED GAINS ON INVESTMENTS	6,291	666	101	3,416	583	11,057
CHANGE IN NET ASSETS PRIOR TO DISTRIBUTIONS	34,288	(467)	2,229	21,885	11,389	69,324
DISTRIBUTIONS TO SPONSOR ORGANIZATIONS	(20,000)	-	-	(40,000)	-	(60,000)
CHANGE IN NET ASSETS	14,288	(467)	2,229	(18,115)	11,389	9,324
NET ASSETS, BEGINNING OF YEAR	59,419	7,478	4,424	101,561	5,907	178,789
NET ASSETS END OF YEAR	$ 73,707	$ 7,011	$ 6,653	$ 83,446	$ 17,296	$ 188,113