SOUTHWEST CATHOLIC
HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

FINANCIAL STATEMENTS

Years Ended June 30, 2010 and 2009

SOUTHWEST CATHOLIC
HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

FINANCIAL STATEMENTS

Years Ended June 30, 2010 and 2009

CONTENTS

	Pages
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS	
Statements of Financial Position	2
Statements of Activities and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5 -16
ADDITIONAL INFORMATION	
Independent Auditors' Report on Additional Information	17
Supplemental Statement of Financial Position	18
Supplemental Statement of Activities and Changes in Net Assets	19

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, 2010 and 2009, 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, 2010 and 2009, 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
September 30, 2010

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

STATEMENTS OF FINANCIAL POSITION

June 30, 2010 and 2009
(In thousands)

ASSETS

	2010	2009
CURRENT ASSETS		
Cash and cash equivalents	$ 36,613	$ 10,483
Short-term investments	31,738	8,317
Receivables:		
Reinsurance receivables, net of allowance for doubtful accounts of $6,700 for 2010 and $5,497 for 2009	45,416	77,810
Reconciliation receivables, net of allowance for doubtful accounts of $0 for 2010 and $7,713 for 2009	1,857	41,857
Capitation and supplement receivables	111,499	33,912
Pharmacy receivable	5,333	4,023
Third party liability receivable, net of allowance for doubtful accounts of $1,639 for 2010 and $0 for 2009	5,242	5,111
Interest receivable	1,026	806
Provider advances, net of allowance for doubtful accounts of $3,232 for 2010 and $2,693 for 2009	13,892	23,544
Due from Aetna	-	222
Other current assets	302	3,239
TOTAL CURRENT ASSETS	252,918	209,324
RECONCILIATION RECEIVABLES, less current portion	9,174	9,437
LONG-TERM INVESTMENTS	143,948	131,688
PENSION ASSET	-	443
TOTAL ASSETS	$ 406,040	$ 350,892

LIABILITIES AND NET ASSETS

	2010	2009
CURRENT LIABILITIES		
Medical claims payable	$ 165,847	$ 219,093
Reconciliation payable	30,245	-
Due to Aetna	9,610	-
Other current liabilities	8,954	1,814
Current portion of risk share settlement	8,794	2,000
TOTAL CURRENT LIABILITIES	223,450	222,907
RISK SHARE SETTLEMENT, less current portion	3,801	3,340
TOTAL LIABILITIES	227,251	226,247
UNRESTRICTED NET ASSETS	178,789	124,645
TOTAL LIABILITIES AND NET ASSETS	$ 406,040	$ 350,892

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, 2010 and 2009
(In thousands)

	2010	2009
OPERATING REVENUES		
Capitation premiums	$ 1,750,431	$ 1,631,316
Delivery/hospital/HIV-AIDS supplement	62,577	73,013
Reinsurance	75,954	102,083
Other, primarily third party recoveries	7,197	6,949
TOTAL OPERATING REVENUES	1,896,159	1,813,361
HEALTH CARE EXPENSES		
Hospitalization	440,221	454,494
Medical compensation	338,461	268,449
Ancillary and other medical services	669,989	659,681
Institutional	122,236	139,673
Home and community based services	109,905	121,390
TOTAL HEALTH CARE EXPENSES	1,680,812	1,643,687
GENERAL AND ADMINISTRATIVE EXPENSES	138,504	127,592
PREMIUM TAX EXPENSE	33,577	30,080
TOTAL EXPENSES	1,852,893	1,801,359
OPERATING INCOME	43,266	12,002
NONOPERATING INCOME (EXPENSE)		
Investment income	8,826	2,137
Investment fees	(832)	(674)
TOTAL NONOPERATING INCOME	7,994	1,463
EXCESS OF REVENUE OVER EXPENSES	51,260	13,465
NET UNRECOGNIZED LOSS ON PENSION PLAN	(2,228)	-
CHANGE IN NET ASSETS PRIOR TO UNREALIZED GAINS (LOSSES) ON INVESTMENTS	49,032	13,465
UNREALIZED GAINS (LOSSES) ON INVESTMENTS	5,112	(6,303)
CHANGE IN NET ASSETS	54,144	7,162
NET ASSETS, BEGINNING OF YEAR	124,645	117,483
NET ASSETS, END OF YEAR	$ 178,789	$ 124,645

See Notes to Financial Statements

SOUTHWEST CATHOLIC HEALTH NETWORK CORPORATION
dba MERCY CARE PLAN

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2010 and 2009
(In thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 54,144	$ 7,162
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Pension asset	443	186
Bad debt expense	10,593	8,949
Net unrealized (gains) losses on investments	(5,112)	6,303
Net realized (gains) losses on investments	(3,902)	4,453
Change in operating assets and liabilities:		
Decrease (increase) in:		
Reinsurance receivables	31,191	11,890
Reconciliation receivables	31,412	14,716
Capitation and supplement receivables	(77,587)	(26,433)
Pharmacy receivable	(1,310)	1,197
Third party liability receivable	(131)	(2,426)
Interest receivable	(220)	77
Provider advances	9,113	1,831
Due from Aetna	222	(222)
Other current assets	2,937	2,751
Increase (decrease) in:		
Medical claims payable	(53,246)	(52,839)
Reconciliation payable	30,245	-
Due to Aetna	9,610	(2,164)
Other current liabilities	7,140	(2,158)
Risk share settlement	7,255	3,974
Net cash provided by (used in) operating activities	52,797	(22,753)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(124,547)	(110,953)
Proceeds from sale of investments	97,880	128,521
Net cash provided by (used in) investing activities	(26,667)	17,568
NET CHANGE IN CASH AND CASH EQUIVALENTS	26,130	(5,185)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	10,483	15,668
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 36,613	$ 10,483

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. 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 $134,230,000 and $122,786,000 for the years ended June 30, 2010 and 2009, 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.

(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). Effective December 31, 2008, HCG discontinued the risk reconciliation. Effective October 1, 2009, DDD implemented a 1.5% risk band for the entire DDD population. 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 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, 2010. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the contract year. The reconciliation limits the contractor's profits and losses to 2%. At June 30, 2010, the Plan has recorded an estimated liability of $20,210,000 due to AHCCCS for the PPC reconciliation contract years 2010 and 2009. At June 30, 2009, reconciliation receivables included approximately $30,302,000 of estimated settlement payments due from AHCCCS for the PPC reconciliation for contract years 2008 and 2007.

Reconciliation balances are stated at the amount management expects to collect or pay. As of June 30, 2010, the Plan recorded a reconciliation receivable of $11,031,000 and a reconciliation payable of $30,245,000. As of June 30, 2009, the Plan recorded a reconciliation receivable of $51,294,000. 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, 2010 and 2009, reconciliation receivables were net of an allowance for doubtful accounts of approximately $0 and $7,713,000, respectively.

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 $62,568,000 and $67,840,000 of this supplemental revenue in fiscal 2010 and 2009, respectively.

Hospital revenue - Hospital supplemental revenue is reimbursement from AHCCCS for certain members who are in an inpatient setting on the date of application for AHCCCS eligibility. This additional one-time reimbursement is intended to help the Plan defray medical costs associated with inpatient stays. Such premiums are recognized in the month that SCHN is informed of the patients' eligibility and services are rendered. AHCCCS discontinued hospital supplemental revenue effective October 1, 2008. The Plan earned approximately $0 and $4,348,000 of this supplemental revenue in fiscal 2010 and 2009, respectively.

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

HIV-AIDS supplemental revenue - HIV-AIDS supplemental revenue is reimbursement from AHCCCS and DDD intended to help defray the costs of HIV/AIDS drugs. Such premiums are recognized in the month that services are rendered. AHCCCS discontinued HIV-AIDS supplemental revenue effective October 1, 2008. The Plan receives HIV-AIDS supplemental revenue from DDD. The Plan earned approximately $9,000 and $825,000 of this supplemental revenue in fiscal 2010 and 2009, 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, 2009	Annual Deductible Effective October 1, 2008	Annual Deductible Effective Prior to October 1, 2008	Coinsurance
AHCCCS Acute – Prospective Only	$ 20,000	$ 35,000	$ 20,000	75%
Title XIX Waiver Group – Prospective Only	20,000	35,000	15,000	75
DES/DDD	20,000	20,000	20,000	75
DES/DDD Ventilator Dependent	No deductible	No deductible	No deductible	100
HCG	135,000	125,000	115,000	90
ALTCS w/Medicare	20,000	20,000	20,000	75
ALTCS w/o Medicare	30,000	30,000	30,000	75
Medicare Advantage	300,000	300,000	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.

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, 2010 and 2009, reinsurance receivable was net of an allowance for doubtful accounts of approximately $6,700,000 and $5,497,000, respectively.

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

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, 2010 and 2009, medical expenses were reduced by approximately $11,127,000 and $8,552,000 of rebates, respectively. At June 30, 2010 and 2009, 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, 2010 and 2009, third party liability receivable was net of an allowance for doubtful accounts of approximately $1,639,000 and $0, 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, 2010 and 2009, provider advance receivables were net of an allowance for doubtful accounts of approximately $3,232,000 and $2,693,000, respectively.

Other current assets - Other assets consist of (in thousands):

	2010	2009
Pre-payments to providers	$ -	2,921
Prepaid expenses	302	318
Total	$ 302	$ 3,239

The pre-payments to providers were recouped through reimbursements by the providers during the year ended June 30, 2010.

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 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 2010 and 2009, recorded at June 30, 2010, is expected to be finalized in late 2011 and 2010, respectively.

Premium deficiency reserve - SCHN evaluates 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, 2010 and 2009, 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.

Management's use of estimates - The preparation of the financial statements in conformity with 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.

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

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. Income determined to be unrelated business taxable income (UBTI) would be taxable.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), which was subsequently incorporated into FASB ASC 740, *Income Taxes*. FIN 48 was originally effective for fiscal years beginning after December 15, 2006. In December 2008, the FASB issued FASB Staff Position No. FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises* ("FSP FIN 48-3") which extended the period of adoption of FIN 48 to fiscal years beginning after December 15, 2008. FIN 48 was adopted in fiscal 2010 and did not have a significant impact on SCHN's financial statements. SCHN evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts.

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

Subsequent events - SCHN has evaluated subsequent events through September 30, 2010, 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 2010, the Acute reconciliation balance shifted from a receivable in fiscal 2009 to a payable in fiscal 2010 due to contract profit limitations. At June 30, 2010, 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):

	2010		2009	
	Reconciliation Receivable	Reconciliation Payable	Reconciliation Receivable	Reconciliation Payable
Acute	$ -	$ 29,030	$ 48,098	$ -
ALTCS	1,107	-	-	-
DDD	-	1,215	-	-
HCG	9,924	-	10,909	-
	11,031	30,245	59,007	-
Allowance for doubtful accounts	-	-	(7,713)	-
	$ 11,031	$ 30,245	$ 51,294	$ -

(3) Investments

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

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Short-term:				
Marketable equity securities	$ 23,429	$ 23,429	$ 1,245	$ 1,246
Corporate bonds	5,183	5,129	2,376	2,342
U.S. Government securities	3,323	3,180	4,663	4,729
	31,935	31,738	8,284	8,317
Long-term:				
Marketable equity securities	59,334	57,822	73,134	68,581
U.S. Government securities	7,223	7,268	21,629	21,484
Corporate bonds	62,405	64,460	25,907	26,388
Mortgage-backed securities	10,169	10,721	11,588	12,082
Preferred securities	3,625	3,677	3,581	3,153
	142,757	143,948	135,839	131,688
	$ 174,692	$ 175,686	$ 144,123	$ 140,005

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

	2010	2009
Revenue (included in nonoperating investment income):		
Interest and dividend income	$ 4,924	$ 6,590
Realized gains (losses) on investments	3,902	(4,453)
	$ 8,826	$ 2,137

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, 2010 and 2009, SCHN recorded a realized loss of $0 and $611,000, respectively, for other-than-temporary declines in the fair value of investments.

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)

The following table summarizes the unrealized losses on investments held at June 30, 2009 (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	$ -	$ -	$ 18,967	$ 196	$ 18,967	$ 196
Marketable equity securities	-	-	37,300	9,455	37,300	9,455
Corporate bonds	1,267	49	4,104	62	5,371	111
Mortgage-backed securities	-	-	83	1	83	1
Preferred securities	-	-	1,846	466	1,846	466
Total	$ 1,267	$ 49	$ 62,300	$ 10,180	$ 63,567	$ 10,229

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.

(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. SCHN adopted FASB ASC 820 as of July 1, 2008 for financial assets and financial liabilities subject to fair value measurement on an initial and a recurring basis. There was no material impact on SCHN's financial statements for the adoption of this standard. 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.

(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

The following table sets forth by level, within the fair value hierarchy, SCHN's investments at fair value as of June 30, 2009 (in thousands):

	(Level 1)	(Level 2)	(Level 3)	Total
U.S. government securities	$ 26,213	$ -	$ -	$ 26,213
Marketable equity securities	69,827	-	-	69,827
Corporate bonds	28,730	-	-	28,730
Mortgage-backed securities	-	12,082	-	12,082
Preferred securities	3,153	-	-	3,153
Total	$ 127,923	$ 12,082	$ -	$ 140,005

(5) Medical claims payable

At June 30, 2010 and 2009, claims outstanding to third parties for health care services provided to plan members, including estimates for incurred but not reported claims, were approximately $166 million and $219 million, respectively. The balances at June 30, 2010 and 2009 were certified by an independent actuary. Activity in the liability for medical claims payable and health care expense for the years ended June 30, 2010 and 2009 is as follows (in thousands):

	2010	2009
Balance at July 1	$ 219,093	$ 271,932
Incurred related to:		
Current year	1,633,064	1,649,282
Prior years	(57,412)	(28,826)
Total incurred	1,575,652	1,620,456
Paid related to:		
Current year	(1,467,677)	(1,459,345)
Prior years	(161,221)	(213,950)
Total paid	(1,628,898)	(1,673,295)
Balance at June 30	$ 165,847	$ 219,093

(5) Medical claims payable (continued)

Estimates for incurred claims are based on historical enrollment, cost trends, and consider operational changes. Future actual results will typically differ from the estimate. 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. Revenue recognized in fiscal 2010 was adjusted to reflect lower costs under risk sharing arrangements.

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 liability for claims unpaid at June 30, 2008 exceeded the actual claims incurred related to fiscal year 2008 and prior by approximately $49 million or 18%. 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 readmittance 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, 2010 and 2009 totaled approximately $5,016,000 and $6,994,000, respectively.

(6) Related party transactions

SCHN paid approximately $98,556,000 in 2010 and $104,100,000 in 2009 to CHW Arizona and approximately $21,185,000 in 2010 and $24,340,000 in 2009 to Carondelet for hospitalization and other medical services provided to its members. These balances include net prospective provider advance payments made to CHW Arizona and Carondelet. At June 30, 2010 provider advances to CHW Arizona and Carondelet amounted to approximately $5,687,000 and $5,471,000, respectively. At June 30, 2009 provider advances to CHW Arizona and Carondelet amounted to approximately $8,875,000 and $11,186,000, respectively.

(7) Retirement benefits

SCHN has 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 will continue 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 is unfunded by approximately $1,772,000 as of June 30, 2010 which is accrued for in other current liabilities on the statement of financial position. The Plan and its related assets and liabilities will be sold during fiscal year 2011.

(7) Retirement benefits (continued)

On June 30, 2007, SCHN adopted the recognition and disclosure provisions of FASB ASC 715, *Compensation-Retirement Benefits*. The adoption of FASB ASC 715, did not have any affect on the recognition of the funded status of the Pension Plan.

SCHN uses a measurement date of July 1 for the Pension Plan. The amount due Pension Plan participants at termination will likely differ from the projected benefit obligation reflected in the table below. The following table sets forth the Pension Plan funded status as provided by independent actuaries at July 1:

	2010	2009
	(In thousands)	
Projected benefit obligation	$ (5,645)	$ 3,616
Fair value of plan assets	3,873	4,059
Funded status of the plan	$ (1,772)	$ 443
Unrecognized net actuarial loss	$ 3,605	$ 1,377
Components of net periodic benefit cost:		
Interest cost	$ 245	$ 245
Expected return on plan assets	(306)	(322)
Recognized net actuarial loss	67	32
Total net periodic pension cost (gains)	$ 6	$ (45)
Employer contributions	$ 13	$ 75
Benefits paid	$ 184	$ 257

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

	2010	2009
Discount rate	4.00%	6.85%
Expected return on plan assets	8.00%	8.00%

Due to the planned termination of the Pension Plan, SCHN has liquidated the Pension Plan's investment assets. Accordingly, all assets are held in cash and cash equivalents at June 30, 2010. SCHN anticipates making adequate contributions to the Pension Plan to ensure that the Pension Plan's assets meet the expected termination liability. SCHN has recorded a net loss on Pension Plan on the statement of activities and changes in net assets to account for unrecognized net actuarial losses due to changes in assumptions in preparation to terminate the Pension Plan.

(8) Commitments and contingencies

Letters of credit - At June 30, 2010 and 2009, 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, 2010 and 2009. No draws have been made on the letters of credit as of June 30, 2010 and 2009. The letters of credit are collateralized by certain investments of SCHN totaling approximately $157,912,000. To meet Medicare requirements, SCHN has entered into demand note agreements dated January 1, 2006 with CHW Arizona 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, 2010 and 2009.

(8) Commitments and contingencies (continued)

Line of credit - At June 30, 2010, SCHN has a temporary line of credit of $30,000,000 to offset potential cash flow shortfall due to the delay of the June 2010 Acute capitation payment of approximately $105,000,000. The credit line term is for sixty (60) days beginning June 21, 2010 and maturing on August 20, 2010. No draws have been made on the credit line as of June 30, 2010 and none are expected to be made.

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, 2010 and 2009, SCHN is in compliance with the AHCCCS covenants. As of June 30, 2009 SCHN was out of compliance with the current ratio under the HCG contract. SCHN obtained a waiver for a current ratio noncompliance from HCG for the year ended June 30, 2009. At June 30, 2010 and 2009, SCHN meets the MCA financial convenants.

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.

(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, 2010, and will be renewed through September 30, 2011, with a one-year renewal option. The DES/DDD contract was renewed through September 30, 2011. The HCG contract is effective through December 31, 2010. The Medicare Advantage contract is renewed annually by CMS.