

MARICOPA COUNTY, ARIZONA
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Report on Audit of Financial Statements
June 30, 2002

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
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<u>Table of Contents</u>	<u>Page</u>
Independent Auditors' Report	1
Statements of Net Assets—Internal Service Funds	2
Statements of Revenues, Expenses, and Changes in Fund Net Assets—Internal Service Funds	3
Statements of Cash Flows—Internal Service Funds	5
Notes to Financial Statements	6



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Board of Supervisors of
Maricopa County, Arizona

We have audited the accompanying financial statements of Maricopa County's Risk Management and Employee Benefits Trust Funds as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Trust Funds' financial statements are intended to present the financial position and changes in financial position and cash flows of only that portion of the governmental activities and aggregate remaining fund information of the County that is attributable to the transactions of the Trust Funds. They do not purport to, and do not, present fairly the financial position of the County as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Maricopa County Risk Management and Employee Benefits Trust Funds as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 1, Maricopa County adopted the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, for the year ended June 30, 2002, to implement a new financial reporting model.

Debbie Davenport
Auditor General

January 21, 2003

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Net Assets—Internal Service Funds
June 30, 2002

	<u>Risk Management</u>	<u>Employee Benefits</u>
Assets		
Current assets:		
Cash and cash equivalents-		
Risk management	\$ 19,758,673	
Environmental insurance claims recovery	1,871,510	
Employee benefits		\$ 9,873,507
Interest receivable	121,892	59,416
Prepaid insurance	2,500,283	2,000
Total current assets	<u>24,252,358</u>	<u>9,934,923</u>
Noncurrent assets:		
Machinery and equipment	74,554	46,108
Less: accumulated depreciation	(51,432)	(24,498)
Total noncurrent assets	<u>23,122</u>	<u>21,610</u>
Total assets	<u>24,275,480</u>	<u>9,956,533</u>
Liabilities		
Current liabilities:		
Accounts payable	529,213	5,139,562
Employee compensation payable	88,918	
Deposits held for others		225,289
Reported and incurred but not reported claims	11,449,440	794,084
Total current liabilities	<u>12,067,571</u>	<u>6,158,935</u>
Noncurrent liabilities:		
Reported and incurred but not reported claims	30,227,939	
Total noncurrent liabilities	<u>30,227,939</u>	
Total liabilities	<u>42,295,510</u>	<u>6,158,935</u>
Net Assets		
Invested in capital assets, net of related debt	23,122	21,610
Restricted for self-insurance (deficit)	(18,043,152)	3,775,988
Total net assets (deficit)	<u>\$ (18,020,030)</u>	<u>\$ 3,797,598</u>

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Revenues, Expenses, and
Changes in Fund Net Assets—Internal Service Funds
Year Ended June 30, 2002

	Risk Management	Employee Benefits
Operating revenues:		
Charges for services	\$ 19,083,216	
Insurance recoveries	336,061	
County and employee premiums		\$ 6,755,185
Other income	2,103	21,824
Total operating revenues	19,421,380	6,777,009
Operating expenses:		
Personal services	1,108,903	
Supplies and services	464,376	
Brokers' fees	42,000	
Consulting and management fees	317,606	
Claims administration service fees	426,583	206,553
Legal expenses	4,564,323	
Claims and insurance:		
Auto liability claims paid	252,503	
Auto liability claims reported decrease in estimate	(160,666)	
Auto liability IBNR claims increase in estimate	83,048	
Total auto liability	174,885	
General liability claims paid	1,606,340	
General liability claims reported increase in estimate	847,828	
General liability IBNR claims increase in estimate	147,633	
Total general liability	2,601,801	
Workers' compensation claims paid	3,478,198	
Workers' compensation claims reported increase in estimate	594,799	
Workers' compensation IBNR claims increase in estimate	1,795,126	
Total workers' compensation	5,868,123	
Medical malpractice claims paid	1,756,845	
Medical malpractice claims reported increase in estimate	859,371	
Medical malpractice IBNR claims decrease in estimate	(3,225,889)	
Total medical malpractice	(609,673)	
Auto physical damage claims paid	172,671	
Auto physical damage claims reported increase in estimate	1,865	
Total auto physical damage	174,536	
Property claims paid	35,960	
Property claims reported increase in estimate	165,220	
Total property	201,180	
Employee dental claims paid		3,945,054
Employee dental claims reported increase in estimate		277,852
Employee dental IBNR claims increase in estimate		209,912
Total employee dental		4,432,818
Short-term disability claims paid		1,243,424
Short-term disability IBNR claims increase in estimate		166,433
Total short-term disability		1,409,857
Unemployment claims	649,152	

See accompanying notes to financial statements.

(Continued)

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Revenues, Expenses, and
Changes in Fund Net Assets—Internal Service Funds
Year Ended June 30, 2002
(Continued)

	Risk Management	Employee Benefits
Environmental contingency	\$ 20,295	
General liability insurance premiums	899,025	
Workers' compensation insurance premiums	267,608	
Individual blanket bonds	26,511	
Property insurance premiums	431,115	
Malpractice insurance premiums	1,821,222	
Health insurance		\$ 312,307
Depreciation	18,506	7,436
Total operating expenses	19,468,077	6,368,971
Operating income (loss)	(46,697)	408,038
Nonoperating revenues (expenses):		
Investment income	853,766	322,408
Loss on disposal of machinery and equipment		(245,425)
Net nonoperating revenues	853,766	76,983
Increase in net assets	807,069	485,021
Total net assets (deficit), July 1, 2001	(18,827,099)	3,312,577
Total net assets (deficit), June 30, 2002	\$ (18,020,030)	\$ 3,797,598

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Cash Flows—Internal Service Funds
Year Ended June 30, 2002

	Risk Management	Employee Benefits
Cash flows from operating activities:		
Receipts from other funds	\$19,083,216	\$6,755,185
Other receipts	338,164	25,139
Payments for fees and services	(6,434,291)	(206,553)
Payments for insurance claims	(7,302,517)	(661,327)
Payments for insurance premiums	(5,268,136)	
Payments to employees	(1,102,072)	
Net cash provided by (used for) operating activities	(685,636)	5,912,444
Cash flows from investing activities:		
Interest received on investments	941,499	306,950
Proceeds from sale of investments held by trustee	2,429,908	
Net cash provided by investing activities	3,371,407	306,950
Net increase in cash and cash equivalents	2,685,771	6,219,394
Cash and cash equivalents, July 1, 2001	18,944,412	3,654,113
Cash and cash equivalents, June 30, 2002	\$21,630,183	\$9,873,507
Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:		
Operating income (loss)	\$ (46,697)	\$ 408,038
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	18,506	7,436
Net change in reported and incurred but not reported claims, noncurrent portion	11,953,924	
Changes in assets and liabilities:		
Increase in:		
Prepaid insurance	(1,802,360)	
Accounts payable	29,946	5,057,763
Employee compensation payable	6,831	
Deposits held for others		3,315
Reported and incurred but not reported claims, current portion		654,197
Decrease in:		
Accrued liabilities	(197)	(218,305)
Reported and incurred but not reported claims, current portion	(10,845,589)	
Net cash provided by (used for) operating activities	\$ (685,636)	\$5,912,444
Noncash investing, capital, and noncapital financing activities:		
Disposal of machinery and equipment		\$ (245,425)
Loss on disposal of machinery and equipment		245,425

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

NOTE 1 - Summary of Significant Accounting Policies

The County, in the exercise of the authority granted by Arizona Revised Statutes (A.R.S.) §11-981, has established a trust fund and declares itself self-insured. For financial statement presentation purposes, the Self-insured Trust Fund is reported as Risk Management and Employee Benefits Trust Funds (Funds) and all monies held in these Funds are considered restricted for self-insurance purposes. The Funds' financial statements are prepared in conformity with U.S. generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB). During the year ended June 30, 2002, Maricopa County implemented GASB Statement No. 34, as amended by GASB Statement No. 37, which prescribes a new reporting model for state and local governments. As a result, the Funds followed the reporting requirements for business-type activities specified by the pronouncement. The Maricopa County *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2002, reports the Funds as governmental activities on the government-wide financial statements since they predominantly service the County's governmental funds. The County also implemented GASB Statement No. 38, which prescribes new and revised note disclosures. A summary of the Funds' more significant accounting policies follows.

A. Reporting Entity

The Self-insured Trust Fund is accounted for as internal service funds of Maricopa County, Arizona, under the direction of an administrator appointed by the County Board of Supervisors. In addition, the trust is administered by no less than six joint trustees, all of whom shall be citizens of the United States of America and residents of Maricopa County. The County Board of Supervisors also appoints the trustees. However, the ultimate financial accountability for the Funds remains with the County. The County is responsible for the management and operations of the financing of the uninsured risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and for certain health benefits (short-term disability and dental) to eligible employees and their dependents.

B. Fund Accounting

The Funds' accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Funds' available resources are observed. The principles of fund accounting require that resources be classified for accounting and reporting purposes into funds in accordance with the activities or objectives specified for those resources. Each fund is considered a separate accounting entity, and its operations are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

The Funds' financial transactions are recorded and reported as internal service funds since their operations are financed and operated in a manner similar to private business enterprises. The intent of the County Board of Supervisors is that the costs (expenses, including depreciation) of providing goods or services to other departments within the County on a continuing basis be financed or recovered primarily through user charges.

C. Basis of Presentation and Accounting

The financial statements include statements of net assets; statements of revenues, expenses, and changes in fund net assets; and statements of cash flows.

The statements of net assets provide information about the assets, liabilities, and net assets of the Funds at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to the availability of assets to satisfy the Funds' obligations. Invested in capital assets net of related debt represents the value of capital assets, net of accumulated depreciation less any outstanding debt incurred to acquire or construct the asset. Restricted net assets represent the balance of monies held in the Funds for self-insurance purposes.

The statements of revenues, expenses, and changes in fund net assets provide information about the Funds' financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in assets are reported. Generally, charges for services, insurance premiums, and insurance recoveries are considered to be operating revenues. Other revenues such as investment income are not generated from operations and are considered to be nonoperating revenues.

The statements of cash flows provide information about the Funds' sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as either operating, noncapital financing, capital financing, or investing.

Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied and determines when revenues and expenses are recognized in the accounts and reported in the financial statements. The financial statements of the Funds are presented on the accrual basis of accounting using the economic resources measurement focus. Revenues are recognized when they are earned, and expenses are recognized when they are incurred, regardless of when the related cash flows take place.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

The Funds apply only those applicable Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

D. Cash and Cash Equivalents

The Funds' cash and cash equivalents are held by the County Treasurer in its investment pool, and they are reported at fair value. The Funds' investments in the County Treasurer's investment pool represents proportionate interests in that pool's portfolio; however, the Funds' portions are not identified with specific investments and are not subject to custodial credit risk. No oversight is provided for the County Treasurer's investment pool, and the pool's structure does not provide for shares. Interest earned from investments purchased with such pooled monies is allocated to each of the funds based on their average daily cash balance on a quarterly basis. Interest earned and not received prior to June 30, is recorded as interest receivable.

For purposes of the statements of cash flows, cash and cash equivalents consist of the Funds' share of the pooled portfolio of specific investments and repurchase agreements purchased by the Maricopa County Treasurer's Office. The County considers only those highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

E. Machinery and Equipment

Machinery and equipment are capitalized at cost. Depreciation of machinery and equipment is charged as an expense against operations. These assets are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives of machinery and equipment range from 3 to 10 years.

F. Employee Compensation Payable

Employee compensation payable consists of payroll and payroll related costs incurred but not paid at June 30, and personal time off (PTO) earned by employees based on services already rendered. Employees may accumulate up to 240 hours of PTO, but any PTO hours in excess of the maximum amount that are unused at calendar year-end will be transferred to family medical leave (FML). FML benefits are used by employees for FML qualifying events and are cumulative but do not vest with employees and therefore, are not accrued. However, upon retirement, employees of the Funds with accumulated FML in excess of 1,000 hours are entitled to a \$3,000 bonus. The amount of such bonuses is accrued in the liability of employee compensation payable.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

NOTE 2 - Reporting Changes

Effective July 1, 2001, as a result of implementing GASB Statement No. 34, the beginning fund equity has been relabeled net assets as of July 1, 2001, on the Statements of Revenues, Expenses, and Changes in Fund Net Assets.

NOTE 3 - Prepaid Insurance

Prepaid insurance for the Risk Management Trust Fund consists of \$2,420,283 of prepaid broker services, workers' compensation, general and auto liability, property, blanket bonds, and malpractice insurance policies. The initial premiums for these policies are amortized pro rata over each policy or contract term using the consumption method. The remaining balance of \$80,000 consists of prepaid deposits to the workers' compensation third party administrator.

Prepaid insurance for the Employee Benefits Trust Fund consists of prepaid deposits to the short-term disability third party administrator.

NOTE 4 - Deposits Held for Others

Deposits held for others consist of employee flexible spending account contributions for health care and dependent care. The balance is composed of the excess of current plan year contributions over withdrawals and forfeitures since program inception.

NOTE 5 - Investment Held by Trustee

In prior years, the County held a U.S. Treasury note with a trustee for unfunded workers' compensation claims as required by the Industrial Commission of Arizona. As of November 2001, the U.S. Treasury note for \$2.4 million was released to the County Treasurer as the County had met the Industrial Commission's self-insurance requirements.

NOTE 6 - Liabilities for Unpaid Claims

The Funds provide for claims liabilities based on estimates of the ultimate cost of claims, including future claims adjustment expenses, that have been reported but not settled, and of claims that have been incurred but not reported.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

The County is liable for any single claim up to the insurance deductible or self-insurance retention (SIR), whichever is applicable, and the excess of insurance limits. The following insurance deductibles, self-insurance retentions, and insurance limits were in effect during fiscal year 2001-02:

<u>Policy Type</u>	<u>Deductible</u>	<u>SIR</u>	<u>Limit</u>
General and auto liability		\$ 2,000,000	\$ 5,000,000
Excess general and auto liability		primary	5,000,000
Property/inland marine	\$ 100,000		666,176,639
including boiler and machinery	100,000		100,000,000
Earthquake	100,000		100,000,000
Flood zones B and C	250,000		100,000,000
Flood zone A	250,000		10,000,000
Difference in conditions		primary	40,000,000
Employee dishonesty	50,000+10%	*	10,000,000
Theft and robbery	5,000		1,000,000
Computer and wire transfer fraud	50,000+10%	*	10,000,000
Forgery alteration/property	5,000		1,000,000
Excess workers' compensation		250,000	statutory
Employer's liability			1,000,000
Self-insurer's guaranty bond	None		250,000
Medical malpractice		2,000,000	15,000,000
Excess medical malpractice		primary	10,000,000
Employee medical		75,000	no limit

* 10% is for claims over \$1,000,000

Settled claims have not exceeded the above commercial insurance coverage limits over the past three years.

Risk Management Trust Fund

Liabilities for unpaid claims are estimates of the ultimate cost of claims that include the insurance deductible, the SIR, and the excess of insurance limits. The estimates are determined by an independent actuary using the following actuarial methods: incurred loss development, paid loss development, frequency/severity, incremental paid-workers' compensation, paid allocated loss adjustment expense to paid loss development, and tail liability for medical malpractice. Total liabilities are equal to the sum of:

1. Reported but unpaid claims (RBUC), which represent the estimated liability on reported claims established by the Risk Management department and

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

2. Incurred but not reported (IBNR) reserves, which include known loss events that are expected to become claims and expected future development on claims already reported. IBNR, therefore, is largely an estimate of loss and claim adjustment expenses associated with future likely claims activity based on historical actual results that establish a reliable pattern.

Accrued actuarial liabilities are based on a discounted 55 percent confidence level assuming a 4.69 percent annual rate of return on future investment income.

The total liabilities reported at June 30, 2002, categorized by RBUC and IBNR by insurable area follow:

	<u>RBUC</u>	<u>IBNR</u>	<u>Total Liabilities</u>
Auto liability	\$ 184,794	\$ 234,132	\$ 418,926
General liability	11,808,127	6,806,137	18,614,264
Workers' compensation	8,598,571	1,981,935	10,580,506
Medical malpractice	3,617,132	8,051,729	11,668,861
Auto physical damage	67,786		67,786
Property	327,036		327,036
			<u>\$ 41,677,379</u>

The total estimates of unpaid claim liabilities of \$41.7 million at June 30, 2002, increased by approximately \$1.1 million from last year's balance of \$40.6 million. A significant reason for this increase was due to SIR's and deductibles that increased while coverage limits have decreased for purchased insurance policies.

Changes in the liabilities for unpaid auto, general, workers' compensation, medical malpractice, auto physical damage, and property claims follow:

	<u>Balance</u> <u>July 1</u>	<u>Current-Year</u> <u>Claims and</u> <u>Changes in</u> <u>Estimates</u>	<u>Claims</u> <u>Payments</u>	<u>Balance</u> <u>June 30</u>
1999-00	\$ 40,772,018	\$ 10,779,261	\$ (8,520,655)	\$ 43,030,624
2000-01	43,030,624	6,181,957	(8,643,537)	40,569,044
2001-02	40,569,044	8,410,852	(7,302,517)	41,677,379

It is estimated that \$11,449,440 of these liabilities will be paid within the next twelve months.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

Employee Benefits Trust Fund

The liability for dental, short-term disability, and medical claims as shown below is based on the fiscal year 2001-02 actuarial reports for dental and short-term disability and the actuarial liability from the 1996-97 actuarial report minus the paid claims for medical. Effective January 1, 1998, all employee medical benefits are now provided through commercial insurance. The County is still liable for claims filed under the previous medical coverage.

Accrued actuarial liabilities at June 30, 2002, for each insurable area follow:

Employee dental	\$ 487,764
Short-term disability	253,461
Employee medical	52,859
Total	\$ 794,084

Changes in the liabilities for unpaid dental, short-term disability, and medical claims follow:

	Balance	Current-Year	Claims	Balance
	<u>July 1</u>	Changes in	Payments	<u>June 30</u>
		<u>Estimates</u>		
1999-00	\$ 176,119	\$ 696,724	\$ (703,676)	\$ 169,167
2000-01	169,167	924,104	(953,384)	139,887
2001-02	139,887	5,842,675	(5,188,478)	794,084

It is estimated that the June 30, 2002, liabilities balance of \$794,084 will be paid within the next twelve months.

NOTE 7 - Net Assets Deficit

The County Board of Supervisors elected not to fund the Risk Management Trust Fund's unpaid claims in fiscal years 1995-96 through 1998-99. Consequently, the Risk Management Trust Fund only billed user departments for operating costs and administrative expenses for those years. This resulted in a total net assets deficit of \$23,321,519 at June 30, 1999. Starting July 1, 1999, Risk Management began billing user departments for actuarially determined claim estimates that are projected to be paid each fiscal year. As of June 30, 2002, the total net assets deficit has been reduced to \$18,020,030.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2002

NOTE 8 - Retirement Plan

Plan Description—The Funds contribute to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The System is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The System issues a comprehensive annual financial report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the ASRS, 3300 North Central Avenue, P.O. Box 33910, Phoenix, AZ 85067-3910 or by calling (602) 240-2000 or (800) 621-3778.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and the Funds' contribution rate. For the year ended June 30, 2002, active plan members and the Funds were each required by statute to contribute at the actuarially determined rate of 2.49 percent (2.00 percent retirement and 0.49 percent long-term disability) of the members' annual covered payroll. The Funds' contributions to the System for the years ended June 30, 2002, 2001, and 2000 were \$22,865, \$23,909, and \$31,546, respectively, which were equal to the required contributions for the year.

NOTE 9 - Subsequent Event

On July 1, 2002, the County renewed its workers' compensation insurance and increased its self-insurance retention from \$250,000 to \$1,000,000. As a result, the Industrial Commission of Arizona required the County to secure an irrevocable letter of credit with a financial institution to cover unfunded workers' compensation claims in the amount of \$8.3 million.