

**MARICOPA COUNTY, ARIZONA**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Report on Audit of Financial Statements**  
**June 30, 2003**

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
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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 the Maricopa County Risk Management and Employee Benefits Trust Funds as of and for the year ended June 30, 2003, 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 the changes in financial position and cash flows of only that portion of the governmental activities and aggregate remaining fund information of Maricopa County that is attributable to the Trust Funds. They do not purport to, and do not, present fairly the financial position of Maricopa County as of June 30, 2003, 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 above present fairly, in all material respects, the financial position of the Maricopa County Risk Management and Employee Benefits Trust Funds as of June 30, 2003, 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.

Dennis L. Mattheisen, CPA  
Financial Audit Director

December 19, 2003

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Statements of Net Assets—Internal Service Funds**  
**June 30, 2003**

	<u>Risk Management</u>	<u>Employee Benefits</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents-		
Risk management	\$ 25,882,241	
Environmental insurance claims recovery	1,680,513	
Employee benefits		\$ 6,175,065
Interest receivable	74,496	23,637
Accounts receivable		768,851
Prepaid insurance	1,638,064	114,481
Total current assets	<u>29,275,314</u>	<u>7,082,034</u>
Noncurrent assets:		
Machinery and equipment	74,554	
Less: accumulated depreciation	(62,654)	
Total noncurrent assets	<u>11,900</u>	
<b>Total assets</b>	<u>29,287,214</u>	<u>7,082,034</u>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	713,737	1,349,210
Employee compensation payable	90,229	
Deposits held for others		331,684
RBUC and IBNR claims	14,372,731	2,446,904
Total current liabilities	<u>15,176,697</u>	<u>4,127,798</u>
Noncurrent liabilities:		
RBUC and IBNR claims	<u>26,675,040</u>	
Total noncurrent liabilities	<u>26,675,040</u>	
<b>Total liabilities</b>	<u>41,851,737</u>	<u>4,127,798</u>
<b>Net Assets</b>		
Invested in capital assets	11,900	
Restricted for self-insurance (deficit)	(12,576,423)	2,954,236
<b>Total net assets (deficit)</b>	<u>\$ (12,564,523)</u>	<u>\$ 2,954,236</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, 2003**

	<b>Risk Management</b>	<b>Employee Benefits</b>
<b>Operating revenues:</b>		
Charges for services	\$ 23,343,431	
County and employee premiums		\$ 12,582,861
Other income		35,098
<b>Total operating revenues</b>	23,343,431	12,617,959
<b>Operating expenses:</b>		
Personal services	1,125,710	
Supplies and services	474,923	
Accounting and auditing fees	13,915	
Actuary fees	30,500	
Consulting and management fees	289,117	
Brokers' fees	115,000	
Claims administration service fees	320,532	
Legal expenses	4,708,769	
Claims and insurance:		
Auto liability claims paid	162,686	
Auto liability RBUC and IBNR claims increase in estimate	54,116	
Total auto liability	216,802	
General liability claims paid	2,019,985	
General liability RBUC and IBNR claims increase in estimate	1,080,377	
Total general liability	3,100,362	
Workers' compensation claims paid	3,481,554	
Workers' compensation RBUC and IBNR claims decrease in estimate	(591,127)	
Total workers' compensation	2,890,427	
Medical malpractice claims paid	366,501	
Medical malpractice RBUC and IBNR claims decrease in estimate	(1,198,272)	
Total medical malpractice	(831,771)	
Auto physical damage claims paid	295,880	
Auto physical damage RBUC claims increase in estimate	43,153	
Total auto physical damage	339,033	
Property claims paid	210,533	
Property RBUC claims decrease in estimate	(17,855)	
Total property	192,678	
Pharmacy claims paid		4,569,118
Pharmacy claims administration fees		23,500
Pharmacy IBNR claims increase in estimate		754,918
Total pharmacy		5,347,536
Dental claims paid		4,386,157
Dental claims administration fees		256,012
Dental IBNR claims decrease in estimate		(43,336)
Total dental		4,598,833
Short-term disability claims paid		1,763,739
Short-term disability claims administration fees		154,490
Short-term disability IBNR claims increase in estimate		175,057
Total short-term disability		2,093,286

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, 2003**  
**(Continued)**

	<b>Risk Management</b>	<b>Employee Benefits</b>
Hospital co-pay reimbursements claims paid		\$ 60,863
Medical incentives paid		749,814
General medical IBNR claims increase in estimate		766,181
<b>Total general medical</b>		<b>1,576,858</b>
Unemployment claims	\$ 833,459	
Environmental contingency	625	
General liability insurance premiums	1,785,680	
Workers' compensation insurance premiums	422,590	
Crime insurance premiums	34,571	
Property insurance premiums	579,794	
Malpractice insurance premiums	1,754,479	
Depreciation	11,222	
<b>Total operating expenses</b>	<b>18,408,417</b>	<b>13,616,513</b>
<b>Operating income (loss)</b>	<b>4,935,014</b>	<b>(998,554)</b>
<b>Nonoperating revenues (expenses):</b>		
Investment income	520,493	195,192
Miscellaneous expenses		(40,000)
<b>Net nonoperating revenues</b>	<b>520,493</b>	<b>155,192</b>
<b>Increase (decrease) in net assets</b>	<b>5,455,507</b>	<b>(843,362)</b>
<b>Total net assets (deficit), July 1, 2002</b>	<b>(18,020,030)</b>	<b>3,797,598</b>
<b>Total net assets (deficit), June 30, 2003</b>	<b>\$ (12,564,523)</b>	<b>\$ 2,954,236</b>

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, 2003**

	<b>Risk Management</b>	<b>Employee Benefits</b>
<b>Cash flows from operating activities:</b>		
Receipts from other funds	\$ 23,343,431	\$ 11,814,010
Other receipts		141,493
Payments for fees, supplies, and services	(5,768,232)	(434,002)
Payments for insurance claims	(7,371,223)	(15,360,043)
Payments for insurance premiums	(3,714,895)	(112,481)
Payments to employees	(1,124,399)	
Net cash provided by (used for) operating activities	5,364,682	(3,951,023)
<b>Cash flows from capital and related financing activities:</b>		
Proceeds from sale of capital assets		21,610
<b>Cash flows from investing activities:</b>		
Interest received on investments	567,889	230,971
Net increase (decrease) in cash and cash equivalents	5,932,571	(3,698,442)
Cash and cash equivalents, July 1, 2002	21,630,183	9,873,507
Cash and cash equivalents, June 30, 2003	\$ 27,562,754	\$ 6,175,065
<b>Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:</b>		
Operating income (loss)	\$ 4,935,014	\$ (998,554)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:		
Depreciation	11,222	
Net change in RBUC and IBNR claims, noncurrent portion	(3,552,899)	
Changes in assets and liabilities:		
Increase in:		
Accounts receivable		(768,851)
Prepaid insurance		(112,481)
Accounts payable	184,524	
Employee compensation payable	1,311	
Deposits held for others		106,395
RBUC and IBNR claims, current portion	2,923,291	1,652,820
Decrease in:		
Prepaid insurance	862,219	
Accounts payable		(3,830,352)
Net cash provided by (used for) operating activities	\$ 5,364,682	\$ (3,951,023)
<b>Noncash investing, capital, and noncapital financing activities:</b>		
Disposal of machinery and equipment		(46,108)
Accumulated depreciation from disposal of machinery and equipment		24,498
Proceeds from sale of capital assets		21,610
Nonoperating miscellaneous expenses incurred but not paid		40,000
Accounts payable		(40,000)

See accompanying notes to financial statements.

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**Notes to Financial Statements**  
**June 30, 2003**

**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). The Maricopa County *Comprehensive Annual Financial Report* for the year ended June 30, 2003, reports the Funds as governmental activities on the government-wide financial statements since they predominantly service the County's governmental funds. A summary of the Funds' more significant accounting policies follows.

**A. Reporting Entity**

The Trust Funds are 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 Funds are 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 (pharmacy, dental, short-term disability, hospital co-pay reimbursements, and medical incentives) 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 comprises its assets, liabilities, net assets, revenues, and expenses.



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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 represents the value of capital assets, net of accumulated depreciation. 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 net assets are reported. Generally, charges for services and insurance premiums 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 recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

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.

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**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. 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 3 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.

**NOTE 2 - Prepaid Insurance**

Prepaid insurance for the Risk Management Trust Fund consists of \$1,558,064 of prepaid broker services and premiums on workers' compensation, general and auto liability, property, crime, and malpractice insurance policies. The initial premiums for these policies are amor-

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tized 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 premiums to the behavioral health vendor.

**NOTE 3 - 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 4 - 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 (RBUC), and of claims that have been incurred but not reported (IBNR).

The County is liable for any single claim up to the insurance deductible or self-insurance retention (SIR), whichever is applicable, and the excess over insurance limits. The following insurance deductibles, self-insurance retentions, and insurance limits were in effect during fiscal year 2002-03:

<u>Policy Type</u>	<u>Deductible</u>	<u>SIR</u>	<u>Limit</u>
General and auto liability		\$ 5,000,000	\$ 5,000,000
Excess general and auto liability		primary	15,000,000
Property/inland marine	\$ 100,000		657,255,579
Boiler and machinery	100,000		50,000,000
Earthquake	100,000		100,000,000
Flood zones B and C	500,000		100,000,000
Flood zone A	500,000		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		1,000,000	25,000,000
Employer's liability			1,000,000
Medical malpractice		5,000,000	15,000,000
Excess medical malpractice		primary	10,000,000

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

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Settled claims have not exceeded the above commercial insurance coverage limits over the past 3 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 over 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
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 2.59 percent annual rate of return on investments.

The total liabilities reported at June 30, 2003, categorized by RBUC and IBNR by insurable area follow:

	<u><b>RBUC</b></u>	<u><b>IBNR</b></u>	<u><b>Total Liabilities</b></u>
Auto liability	\$ 310,237	\$ 162,805	\$ 473,042
General liability	11,319,391	8,375,250	19,694,641
Workers' compensation	7,793,054	2,196,325	9,989,379
Medical malpractice	4,094,446	6,376,143	10,470,589
Auto physical damage	110,939		110,939
Property	309,181		309,181
			<u><u>\$ 41,047,771</u></u>

The total estimates of unpaid claim liabilities of \$41,047,771 at June 30, 2003, decreased by \$629,608 from last year's balance of \$41,677,379. The areas that significantly decreased were medical malpractice and workers' compensation.

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**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
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Changes in the liabilities for unpaid auto, general, workers' compensation, medical malpractice, auto physical damage, and property claims follow:

	<b>Balance</b>	<b>Current-Year</b>	<b>Claims</b>	<b>Balance</b>
	<b><u>July 1</u></b>	<b>Changes in</b>	<b>Payments</b>	<b><u>June 30</u></b>
		<b><u>Estimates</u></b>		
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
2002-03	41,677,379	5,907,531	(6,537,139)	41,047,771

It is estimated that \$14,372,731 of these liabilities will be paid within the next 12 months.

**Employee Benefits Trust Fund**

The liability for pharmacy, dental, short-term disability, and hospital co-pay reimbursements claims as shown below is based on the fiscal year 2002-03 actuarial reports. The liability for medical incentives as shown below is based on the contract with CIGNA HealthCare (CIGNA). Beginning in fiscal year 2002-03, hospital co-pay reimbursements and medical incentives are included in the estimated IBNR rather than being expensed when paid. Effective January 1, 2003, all employee pharmacy benefits for CIGNA enrollees are now self-insured by the County.

Accrued liabilities at June 30, 2003, for each insurable area follow:

Pharmacy	\$ 807,777
Dental	444,428
Short-term disability	428,518
Hospital co-pay reimbursements	16,181
Medical incentives	750,000
Total	<u>\$ 2,446,904</u>

Changes in the liabilities for unpaid pharmacy, dental, short-term disability, hospital co-pay reimbursements, and medical incentives claims follow:

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	<b>Balance</b>	<b>Current-Year</b>	<b>Claims</b>	<b>Balance</b>
	<b><u>July 1</u></b>	<b>Claims and</b>	<b><u>Payments</u></b>	<b><u>June 30</u></b>
		<b>Changes in</b>		
		<b><u>Estimates</u></b>		
2000-01	\$ 169,167	\$ 924,104	\$ (953,384)	\$ 139,887
2001-02	139,887	5,842,675	(5,188,478)	794,084
2002-03	794,084	13,182,511	(11,529,691)	2,446,904

It is estimated that the June 30, 2003, liabilities balance of \$2,446,904 will be paid within the next 12 months.

**NOTE 5 - 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, 2003, the total net assets deficit has been reduced to \$12,564,523.

**NOTE 6 - Letter of Credit**

On July 1, 2002, the County renewed its workers' compensation insurance with a self-insured retention of \$1,000,000. As a result, the Industrial Commission of Arizona required the County to secure an irrevocable letter of credit in the amount of \$8.3 million with a financial institution to cover unfunded workers' compensation claims. During fiscal year 2002-03, the letter of credit had not been drawn upon. The letter of credit was renewed to July 1, 2004, for \$9.1 million.

**NOTE 7 - Retirement Plan**

**Plan Description**—The Risk Management Fund contributes 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.

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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 Risk Management Fund's contribution rates. For the year ended June 30, 2003, active plan members and the Risk Management Fund 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 Risk Management Fund's contributions to the System for the years ended June 30, 2003, 2002, and 2001 were \$22,894, \$22,865, and \$23,909, respectively, which were equal to the required contributions for the year.

**NOTE 8 – Subsequent Event**

On January 1, 2004, the Employee Benefits Trust Fund assumed the responsibility for managing and operating HealthSelect, a managed care health plan. HealthSelect provides health care coverage to Maricopa County employees electing this plan and their dependents. The Maricopa Integrated Health System (MIHS) previously managed and operated the plan; however, MIHS will become a special health care district since voters passed Proposition 414 in the November 2003 special election. The County negotiated amended contracts with its existing general medical and pharmacy vendors to perform administrative services such as but not limited to claims and member management. HealthSelect expenses will be paid from premiums paid by the plan's members and the County. Estimated premiums and expenses for January 1, 2004 through June 30, 2004 for this plan are \$6 million.