

REPORT HIGHLIGHTS

FINANCIAL STATEMENT AUDIT

Subject

Pima Health Care System issues financial statements annually. The financial statements include the financial activity of Pima Health System and Services and Kino Community Hospital. The System is responsible for preparing financial statements, maintaining strong internal controls, and demonstrating accountability for its use of public monies. As the auditors, we determined whether the System has met its responsibilities.

Our Conclusion

The information in the financial statements is fairly stated in all material respects, and the financial statements can be relied on. Also, the System maintained adequate internal controls and substantially complied with the Arizona Health Care Cost Containment System's (AHCCCS) contract requirements. However, auditors noted that the County failed to comply with AHCCCS's reserve requirements for its health plans. See page two for further information.



2004

Year Ended June 30, 2004

Kino Community Hospital's License Transfers to University Physicians, Inc.

Pima County has entered into a contract to lease Kino Community Hospital to University Physicians, Inc. (UPI), a nonprofit organization. On June 16, 2004, the Hospital's license was transferred and UPI began operating the Hospital. The significant provisions of the contract include the following:

- UPI is leasing the Hospital's buildings for \$10 a year. The initial term of the lease is 25 years, with extension and termination options.
- The County is required to pay UPI an annual service fee during the first 10 years of the contract to support the continued operations of the Hospital. The service fee will be paid by the County's General Fund and is subject to maximum amounts defined within the agreement. The service fee totals \$127 million over the 10 year period and varies annually from a maximum of approximately \$25 million in fiscal year 2005 to a low of \$7.7 million in fiscal year 2014.
- Pima County and UPI will create a joint Master Development Plan for the expansion of healthcare facilities on the Hospital's premises and on several acres of county-owned land that is adjacent to the Hospital's premises.

UPI will construct improvements subject to availability of the Hospital's operating monies and Pima County service fees. In addition, Pima County will construct a health center and psychiatric facility with \$37 million of its general obligation bond monies.

- UPI will obtain and maintain all appropriate insurance policies related to hospital operations.

Some of the Hospital's equipment and inventories were sold to UPI. The Hospital's remaining assets and liabilities were retained by the County as summarized in the table below.

Kino Community Hospital Disposition of Net Assets June 15, 2004 (In millions)

Net assets	\$13.7
Asset and liabilities retained by the County:	
Property leased to UPI	8.3
Note receivables for equipment and supplies	2.0
Receivables and other current Assets	10.0
Payables and other current Liabilities	<u>(6.7)</u>
Net assets retained by the County	<u>(13.6)</u>
Loss on disposition of Hospital net assets	<u>\$ 0.1</u>

The County Failed to Comply with AHCCCS Reserve Requirements

The County's contractual agreements with the Arizona Health Care Cost Containment System (AHCCCS) require that the County maintain certain financial reserves for its AHCCCS and long-term care (ALTCS) Health Plans. During the fiscal year, the County requested that the contractual reserve requirements be reduced and AHCCCS agreed to lower the reserve requirements. However, as shown in the table to the right, the County failed to comply with the reduced financial reserve requirements as of June 30, 2004. In total, the plans' reserves were \$4.1 million below the required reserves. The ALTCS plan reserves were \$4.3 million below and the AHCCCS plan reserves were \$0.2 million above the required reserves.

During the fiscal year, the ALTCS plan's financial reserves decreased because the plan had a loss of \$8.3 million. Furthermore, both plans' financial reserves have declined because over the past 5 years the County transferred more than \$30 million from the plans to the County's General Fund to help finance other healthcare services.

Health Plan Net Assets Compared to AHCCCS Reserve Requirements As of June 30, 2004 (In millions)

	AHCCCS	ALTCS
Net assets	\$4.0	\$ 0.0
Required reserves	<u>3.8</u>	<u>4.3</u>
Over (under) requirement	<u>\$0.2</u>	<u>\$(4.3)</u>

Statement of Revenues, Expenses, and Changes in Net Assets Year Ended June 30, 2004 (In millions)

	AHCCCS	ALTCS
Operating revenues	\$ 71.4	\$ 133.5
Operating expenses	(67.9)	(140.0)
Nonoperating expenses	<u>(.9)</u>	<u>(1.8)</u>
Income (loss)	<u>2.6</u>	<u>(8.3)</u>
Transfers out	<u>(3.0)</u>	<u>(.5)</u>
Decrease in net assets	<u>(.4)</u>	<u>(8.8)</u>
Total net assets, July 1, 2003	<u>4.4</u>	<u>8.8</u>
Total net assets, June 30, 2004	<u>\$ 4.0</u>	<u>\$ -0-</u>

TO OBTAIN MORE INFORMATION

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Year Ended June 30, 2004