

MARICOPA COUNTY, ARIZONA
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Report on Audit of Financial Statements
June 30, 2000

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
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, 2000, 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 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 financial statements present only Maricopa County's Risk Management and Employee Benefits Trust Funds and are not intended to present fairly the financial position of the Proprietary Fund Types—Internal Service Funds of Maricopa County, Arizona, and the results of their operations and cash flows in conformity with 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 Maricopa County's Risk Management and Employee Benefits Trust Funds as of June 30, 2000, and the results of their operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

Debbie Davenport
Auditor General

October 12, 2000

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Balance Sheets—Internal Service Funds
June 30, 2000

	<u>Risk Management</u>	<u>Employee Benefits</u>
Assets		
Current assets:		
Cash and cash equivalents-		
Risk management	\$ 15,505,193	
Environmental insurance claims recovery	2,026,433	
Employee benefits		\$ 3,788,563
Interest receivable	189,724	42,303
Due from other governmental units		19,342
Prepaid insurance	650,255	2,000
Total current assets	<u>18,371,605</u>	<u>3,852,208</u>
Restricted assets:		
Investments held by trustee	2,347,238	
Total restricted assets	<u>2,347,238</u>	
Property, plant, and equipment:		
Machinery and equipment	110,693	96,969
Less: accumulated depreciation	(45,491)	(27,526)
Net property, plant, and equipment	<u>65,202</u>	<u>69,443</u>
Total assets	<u>\$ 20,784,045</u>	<u>\$ 3,921,651</u>
Liabilities and fund equity		
Liabilities:		
Accounts payable	\$ 771,818	\$ 36,685
Accrued liabilities		929,285
Employee compensation payable	84,550	56,424
Deposits held for others		153,258
Reported but unpaid claims:		
Auto liability	201,704	
General liability	11,585,266	
Workers' compensation	8,491,665	
Medical malpractice	7,947,429	
Auto physical damage	66,793	
Property	245,725	
Incurred but not reported claims:		
Auto liability	655,660	
General liability	5,074,823	
Workers' compensation	(103,201)	
Medical malpractice	8,864,760	
Employee medical		82,139
Short-term disability		87,028
Total liabilities	<u>43,886,992</u>	<u>1,344,819</u>
Fund equity:		
Contributed capital	2,886,478	30,445
Retained earnings (accumulated deficit)	(25,989,425)	2,546,387
Total fund equity (deficit)	<u>(23,102,947)</u>	<u>2,576,832</u>
Total liabilities and fund equity	<u>\$ 20,784,045</u>	<u>\$ 3,921,651</u>

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Revenues, Expenses, and
Changes in Fund Equity—Internal Service Funds
Year Ended June 30, 2000

	<u>Risk Management</u>	<u>Employee Benefits</u>
Operating revenues:		
Charges for services	\$ 18,134,977	\$ 1,524,415
Insurance recoveries	263,560	
County and employee premiums		44,728,689
Other		31,138
Total operating revenues	18,398,537	46,284,242
Operating expenses:		
Personal services	941,179	521,431
Supplies and services	477,355	298,749
Brokers' fees	39,000	
Consulting and management fees	314,856	162,205
Claims administration service fees	201,828	69,254
Legal expenses	4,395,331	
Claims and insurance:		
Auto liability claims paid	410,456	
Auto liability claims reported decrease in estimate	(87,892)	
Auto liability IBNR claims decrease in estimate	(260,223)	
Total auto liability	62,341	
General liability claims paid	2,691,063	
General liability claims reported decrease in estimate	(2,144,703)	
General liability IBNR claims increase in estimate	1,598,160	
Total general liability	2,144,520	
Workers' compensation claims paid	2,900,655	
Workers' compensation claims reported increase in estimate	1,692,352	
Workers' compensation IBNR claims increase in estimate	41,300	
Total workers' compensation	4,634,307	
Medical malpractice claims paid	2,249,380	
Medical malpractice claims reported decrease in estimate	(541,631)	
Medical malpractice IBNR claims increase in estimate	1,975,462	
Total medical malpractice	3,683,211	
Auto physical damage claims paid	181,378	
Auto physical damage claims reported decrease in estimate	(17,715)	
Total auto physical damage	163,663	
Property claims paid	87,723	
Property claims reported increase in estimate	3,496	
Total property	91,219	
Employee medical claims paid		6,952
Employee medical IBNR claims decrease in estimate		(6,952)
Total employee medical		0
Short-term disability claims paid		696,724
Short-term disability IBNR claims increase (decrease) in estimate		0
Total short-term disability		696,724

See accompanying notes to financial statements.

(Continued)

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Statements of Revenues, Expenses, and
Changes in Fund Equity—Internal Service Funds
Year Ended June 30, 2000
(Continued)

	Risk Management	Employee Benefits
General liability insurance premiums	\$ 482,718	
Workers' compensation insurance premiums	152,781	
Individual blanket bonds	21,308	
Unemployment claims	339,966	
Property insurance premiums	283,288	
Malpractice insurance premiums	579,548	
Depreciation	17,058	\$ 9,733
Dental insurance		3,712,378
Health insurance		36,022,269
Life insurance		2,735,419
Mental health programs		1,132,154
Sightcare insurance		421,267
Other insurance		180,194
Total operating expenses	19,025,477	45,961,777
Operating income (loss)	(626,940)	322,465
Nonoperating revenues (expenses):		
Investment income	845,512	173,985
Loss on disposal of property, plant, and equipment		(26,287)
Net nonoperating revenues	845,512	147,698
Net income	218,572	470,163
Fund equity (deficit), July 1, 1999	(23,321,519)	2,106,669
Fund equity (deficit), June 30, 2000	\$ (23,102,947)	\$ 2,576,832

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, 2000

	Risk Management	Employee Benefits
Cash flows from operating activities:		
Operating income (loss)	\$ (626,940)	\$ 322,465
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	17,058	9,733
Net change in liability for incurred but not reported claims	3,354,699	(6,952)
Changes in assets and liabilities:		
Increase in:		
Due from other governmental units		(19,342)
Accrued liabilities		303,126
Accounts payable	441,339	4,629
Decrease in:		
Other receivable		83,225
Due from other County funds		1,618,745
Prepaid insurance	28,459	
Employee compensation payable	(21,710)	(5,498)
Due to other County funds	(3,012)	(1,355)
Deposits held for others		(10,837)
Liability for reported but unpaid claims	(1,096,093)	
Net cash provided by operating activities	2,093,800	2,297,939
Cash flows from capital and related financing activities:		
Acquisition of machinery and equipment	(30,881)	(26,814)
Net cash used for capital and related financing activities	(30,881)	(26,814)
Cash flows from investing activities:		
Interest on investments	817,612	145,401
Proceeds from sale of investments held by trustee	2,363,476	
Purchase of investments held by trustee	(2,347,238)	
Net cash provided by investing activities	833,850	145,401
Net increase in cash and cash equivalents	2,896,769	2,416,526
Cash and cash equivalents, July 1, 1999	14,634,857	1,372,037
Cash and cash equivalents, June 30, 2000	\$ 17,531,626	\$3,788,563
Noncash investing, capital, and financing activities:		
Disposal of property, plant, and equipment		\$ (90,452)
Elimination of accumulated depreciation related to disposals		64,165
Loss on disposal of property, plant, and equipment		26,287

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2000

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). The Funds' financial statements are prepared in conformity with generally accepted accounting principles, as set forth primarily in Governmental Accounting Standards Board (GASB) Statements No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* and No. 30, *Risk Financing Omnibus*. A summary of the more significant accounting policies of the Funds follows.

A. Reporting Entity

The Self-Insured Trust Fund is under the direction of an administrator appointed by the Board of Supervisors of Maricopa County, Arizona. In addition, the trust is administered by no less than nine joint trustees, all of whom shall be citizens of the United States of America and residents of Maricopa County, Arizona. 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 (major medical and short-term disability) to eligible employees and their dependents.

B. Fund Accounting

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

The Funds' accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on their 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, fund equity, 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. The measurement focus of the Funds is on the flow of economic resources. With this measurement focus, all assets and all liabilities associated with the operations of the Funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. The operating statement presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

C. Basis of Accounting

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. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. Interfund transfers that would be treated as revenues or expenses if they involved parties external to Maricopa County are recorded in the appropriate revenue or expense account.

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 statement 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.

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E. Property, Plant, and Equipment

Property, plant, and equipment are capitalized at cost. Depreciation of property, plant, 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 at June 30, personal time off (PTO) and a calculated amount of family/medical leave (FML) 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 year-end will be transferred to 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 - Due from Other Governmental Units

Due from other governmental units for the Employee Benefits Trust Fund consists of insurance premiums withheld from retirees' pension checks by the Public Safety Personnel Retirement System and not transferred to the County prior to June 30.

NOTE 3 - Prepaid Insurance

Prepaid insurance for the Risk Management Trust Fund consists of \$570,255 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.

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NOTE 4 - Investments Held by Trustee

Investments held by trustee consist of a one-year U.S. Treasury note that matures on June 30, 2001, and is stated at cost, which approximates fair value. The investment was purchased by an outside financial institution and held by its trustee in the County's name. The investment is held as a performance bond for unfunded workers' compensation claims as required by the Industrial Commission of Arizona.

NOTE 5 - 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 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.

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 1999-00:

<u>Policy Type</u>	<u>Deductible</u>	<u>SIR</u>	<u>Limit</u>
General and auto liability		\$ 1,000,000	\$ 25,000,000
Excess general and auto liability		primary	25,000,000
Property liability/inland marine including boiler and machinery	\$ 100,000		601,095,289
Earthquake			10,000,000
Flood zones B and C			100,000,000
Flood zone A			10,000,000
Difference in conditions			40,000,000
Employee dishonesty	50,000		10,000,000
Theft and robbery	5,000		1,000,000

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<u>Policy Type</u>	<u>Deductible</u>	<u>SIR</u>	<u>Limit</u>
Computer and wire transfer fraud	\$ 50,000		\$ 10,000,000
Forgery alteration/property	5,000		1,000,000
Aviation (owner, landlord, and tenant – OL&T) premises	none		20,000,000
Excess workers' compensation		\$ 250,000	statutory
Employer's liability			1,000,000
Self-insurer's guaranty bond	none		250,000
Medical malpractice		1,000,000	10,000,000
Excess medical malpractice		primary	15,000,000
Employee medical		75,000	no limit

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, exposure/loss rate (incurred losses), and the exposure/loss rate (paid losses). 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 5.27 percent annual rate of return on future investment income.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2000

The liabilities reported at June 30, 2000, for each insurable area follow:

Auto liability	\$ 857,364
General liability	16,660,089
Workers' compensation	8,388,464
Medical malpractice	16,812,189
Auto physical damage	66,793
Property	245,725
Total	<u>\$ 43,030,624</u>

The total estimates of unpaid claim liabilities of \$43.0 million at June 30, 2000, increased by approximately \$2.2 million from last year's balance of \$40.8 million. Most of the increase in the estimates of unpaid claim liabilities occurred in workers' compensation. The workers' compensation estimated reserve increased, since there has been a decrease in the closure rate of claims, resulting in a higher reported but unpaid claims liability.

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

	Balance	Current-Year		Balance
	<u>July 1</u>	Claims and		<u>June 30</u>
		Changes in	Claims	
		<u>Estimates</u>	<u>Payments</u>	
1997-98	\$ 27,589,951	\$ 10,949,249	\$ (8,166,303)	\$ 30,372,897
1998-99	30,372,897	19,724,588	(9,325,467)	40,772,018
1999-00	40,772,018	10,779,261	(8,520,655)	43,030,624

Employee Benefits Trust Fund

The liability for medical and short-term disability claims as shown below is based on the fiscal year 1996-97 actuarial report and claims paid in fiscal years 1997-98, 1998-99, and 1999-00. 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.

MARICOPA COUNTY
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Notes to Financial Statements
June 30, 2000

Accrued actuarial liabilities at June 30, 2000, for each insurable area follow:

Employee medical	\$	82,139
Short-term disability		87,028
Total		\$ 169,167

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

	Balance July 1	Current-Year Claims and Changes in Estimates	Claims Payments	Balance June 30
1997-98	\$ 3,664,306	\$ 7,175,112	\$ (10,346,151)	\$ 493,267
1998-99	493,267	442,472	(759,620)	176,119
1999-00	176,119	696,724	(703,676)	169,167

NOTE 7 - Fund 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 fund deficit of \$23,102,947 at June 30, 2000. Starting July 1, 1999, Risk Management began billing user departments for actuarially determined claim estimates that are projected to be paid each fiscal year.

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. 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.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
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Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and the Funds' contribution rates. For the year ended June 30, 2000, active plan members and the Funds were each required by statute to contribute at the actuarially determined rate of 2.66 percent (2.17 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, 2000, 1999, and 1998 were \$31,546, \$47,554, and \$47,517 respectively, which were equal to the required contributions for the year.

NOTE 9 - Subsequent Change in Classification of Revenues and Expenses

Effective July 1, 2000, the County will be reporting only self-insurance activities in the Employee Benefits Trust Fund. Administrative costs and activities that are not self-insured will no longer be reported. This change will result in an approximate 85 percent decrease in Employee Benefits Trust Fund revenues and expenses.