MARICOPA COUNTY, ARIZONA
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Report on Audit of Financial Statements
June 30, 1998

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DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
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, 1998, 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, 1998, and the results of their operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 7 to the financial statements, the County implemented Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. As a result, the County changed its method of accounting for investments in fiscal year 1997-98.

Debbie Davenport
Deputy Auditor General

October 22, 1998

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MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Balance Sheets—Internal Service Funds
June 30, 1998

	Risk Management	Employee Benefits
Assets		
Current assets:		
Cash and cash equivalents	$ 18,024,314	$ 1,946,486
Interest receivable	208,935	22,437
Insurance recovery receivable	63,059	
Due from other governmental units		16,720
Due from other County funds	47,427	235,574
Prepaid insurance	610,548	2,000
Total current assets	18,954,283	2,223,217
Restricted assets:		
Investments held by trustee	5,645,707	
Total restricted assets	5,645,707	
Property, plant, and equipment:		
Buildings		87,981
Machinery and equipment	60,445	104,418
Less: accumulated depreciation	(15,678)	(87,066)
Net property, plant, and equipment	44,767	105,333
Total assets	$ 24,644,757	$ 2,328,550
Liabilities and fund equity		
Liabilities:		
Accounts payable	$ 761,827	$ 146,460
Employee compensation payable	54,481	42,519
Deposits held for others		154,692
Use tax	110	
Reported but unpaid claims:		
Auto liability	721,461	
General liability	7,482,919	
Workers' compensation	4,308,819	
Medical malpractice	5,246,991	
Auto physical damage	75,607	
Property	342,323	
Employee medical		159,490
Incurred but not reported claims:		
Auto liability	356,252	
General liability	4,136,755	
Workers' compensation	994,479	
Medical malpractice	6,809,143	
Auto physical damage	(4,322)	
Property	(97,530)	
Employee medical		246,749
Disability		87,028
Total liabilities	31,189,315	836,938
Fund equity:		
Contributed capital	1,355,418	30,445
Retained earnings (accumulated deficit)	(7,899,976)	1,461,167
Total fund equity (deficit)	(6,544,558)	1,491,612
Total liabilities and fund equity	$ 24,644,757	$ 2,328,550

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, 1998

	Risk Management	Employee Benefits
Operating revenues:		
Charges for services	$ 4,515,547	$ 1,668,916
County and employee premiums		40,897,058
Other	117,659	
Total operating revenues	4,633,206	42,565,974
Operating expenses:		
Personal services	865,539	476,736
Supplies and services	319,411	910,354
Brokers' fees	42,000	
Consulting and management fees	45,000	134,698
Claims administration service fees	210,221	65,620
Legal expenses	2,850,542	
Claims and insurance:		
Auto liability claims paid	349,580	
Auto liability claims reported	421,527	
Auto liability IBNR claims	(74,060)	
Total auto liability	697,047	
General liability claims paid	1,273,348	
General liability claims reported	(2,988,485)	
General liability IBNR claims	3,935,437	
Total general liability	2,220,300	
Workers' compensation claims paid	2,171,890	
Workers' compensation claims reported	1,447,762	
Workers' compensation IBNR claims	(561,676)	
Total workers' compensation	3,057,976	
Medical malpractice claims paid	3,783,750	
Medical malpractice claims reported	2,360,776	
Medical malpractice IBNR claims	(1,604,719)	
Total medical malpractice	4,539,807	
Property/auto physical damage claims paid	587,735	
Property/auto physical damage claims reported	173,236	
Property/auto physical damage IBNR claims	(101,852)	
Total property/auto physical damage	659,119	
Environmental liability IBNR claims	(225,000)	
Total environmental liability	(225,000)	
General liability insurance premiums	492,739	
Workers' compensation insurance premiums	159,825	
Individual blanket bonds	25,698	
Unemployment claims	530,414	
Property insurance premiums	218,695	
Malpractice insurance premiums	529,267	
Depreciation	9,802	24,533
Dental insurance		2,492,118
Disability insurance		448,109

See accompanying notes to financial statements.

(Continued)

Statements of Revenues, Expenses, and
Changes in Fund Equity—Internal Service Funds
Year Ended June 30, 1998
(Continued)

	Risk Management	Employee Benefits
Health insurance		$ 33,230,816
Life insurance		2,241,900
Mental health programs		1,260,951
Sightcare insurance		133,783
Other insurance		64,698
Total operating expenses	$ 17,248,402	41,484,316
Operating income (loss)	(12,615,196)	1,081,658
Nonoperating revenues (expenses):		
Interest income	1,426,430	245,503
Operating transfers out	(814)	(34,070)
Net nonoperating revenues	1,425,616	211,433
Net income (loss)	(11,189,580)	1,293,091
Fund equity, July 1, 1997 - as adjusted	4,645,022	198,521
Fund equity (deficit), June 30, 1998	$ (6,544,558)	$ 1,491,612

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, 1998

	Risk Management	Employee Benefits
Cash flows from operating activities:		
Operating income (loss)	$(12,615,196)	$ 1,081,658
Adjustments to reconcile operating income (loss) to net cash used for operating activities:		
Depreciation	9,802	24,533
Net change in liability for incurred but not reported claims	1,368,130	(1,600,011)
Changes in assets and liabilities:		
Increase in:		
Insurance recovery receivable	(63,059)	
Due from other governmental units		(16,720)
Investments held by trustee	(30,707)	
Employee compensation payable	25,239	
Use tax	110	
Liability for reported but unpaid claims	1,414,816	
Decrease in:		
Other receivable		49,286
Due from other County funds	100,505	1,546,229
Prepaid insurance	61,551	
Accounts payable	(479,043)	(2,751,719)
Due to other County funds	(1,751)	
Deposits held for others		(19,254)
Employee compensation payable		(12,742)
Liability for reported but unpaid claims		(1,571,028)
Net cash used for operating activities	(10,209,603)	(3,269,768)
Cash flows from noncapital financing activities:		
Operating transfers to other County funds	(814)	(34,070)
Net cash used for noncapital financing activities	(814)	(34,070)
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(24,447)	(47,963)
Net cash used for capital and related financing activities	(24,447)	(47,963)
Cash flows from investing activities:		
Interest on investments	1,636,887	272,389
Net cash provided by investing activities	1,636,887	272,389
Net decrease in cash and cash equivalents	(8,597,977)	(3,079,412)
Cash and cash equivalents, July 1, 1997 - as adjusted	26,622,291	5,025,898
Cash and cash equivalents, June 30, 1998	$ 18,024,314	$ 1,946,486
Noncash activities:		
Restatement of cash and cash equivalents and retained earnings at July 1, 1997 (GASB Statement No. 31)	$ (57,294)	$ (10,809)

See accompanying notes to financial statements.

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 accordance 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 (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) 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 comprises its assets, liabilities, fund equity, revenues, and expenses.

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

For the year ended June 30, 1998, the County adopted the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which require certain investments to be reported at fair value rather than at cost.

Cash belonging to the County is placed in the custody of the Maricopa County Treasurer's Office. A.R.S. authorizes the County Treasurer to invest public monies in the State Treasurer's investment pool; interest-bearing savings accounts, certificates of deposit and repurchase agreements in eligible depositories; bonds or other obligations of the U.S. government that are guaranteed as to principal and interest by the U.S. government; and bonds of the State of Arizona counties, cities, towns, school districts, and special districts as specified by statute. As required by statute, collateral is required for demand deposits, certificates of deposit, and repurchase agreements at 101 percent of all deposits not covered by federal depository insurance.

Cash and investments held by the County Treasurer consists of both County monies and monies of other entities not under the control of the County Board of Supervisors (i.e., primarily monies of the various school districts). However, the Treasurer has a fiduciary responsibility to administer all monies held in the County Treasury. The Treasurer invests, on a pooled basis, all cash not specifically invested for a fund or program. 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. The Funds' share of monies held with the Treasurer are reported at fair value in accordance with the requirements of GASB Statement No. 31.

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

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, equipment, and buildings ranges from 3 to 10 years.

F. Accounts Payable

Accounts payable consists of goods or services received but not paid at June 30.

G. 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.

H. Deposits Held for Others

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

I. Liability 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 length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claims costs are dependent on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities cannot yield an exact result, particularly for liability coverage. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques for producing current estimates of actual claim costs, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Given the complexity of this estimating process, the ultimate liability may be more or less than such estimates indicate. Consequently, adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

The County is liable for any single claim up to the self-insurance retention (SIR) or insurance deductible, 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 1997-98:

Policy Type	Deductible	SIR	Limit
General and auto liability		$ 1,000,000	$ 25,000,000
Property liability	$ 100,000		660,735,395
Flood and earthquake liability	300,000		10,000,000
Boiler and machinery	100,000		50,000,000
Employee dishonesty	50,000		10,000,000
Theft and robbery	5,000		1,000,000
Computer and wire transfer fraud	50,000		10,000,000
Forgery alteration/property	5,000		1,000,000
Policy Type	Deductible	SIR	Limit

Aviation (owner , landlord, and tenant - OL&T) premises			$ 10,000,000
Excess workers' compensation		$ 250,000	Statutory
Medical malpractice		1,000,000	10,000,000
Excess medical malpractice	primary		5,000,000
Employee medical		75,000	No limit

Effective January 1, 1998, all employee medical benefits are provided through commercial insurance. The County is still liable for all claims filed per employee under the previous coverage up to the self-insurance retention.

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

NOTE 2 – Due from Other Governmental Units

Due from other governmental units for the Employee Benefits Trust Fund consist of retiree premiums due from the Public Safety Personnel Retirement System.

NOTE 3 - Due from Other County Funds

Due from other County funds for the Risk Management Trust Fund consist of loans made to several special improvement districts.

Due from other County funds for the Employee Benefits Trust Fund consist of insurance premiums withheld from County payroll incurred at year-end and not transferred prior to June 30, 1998.

NOTE 4 - Prepaid Insurance

Prepaid insurance for the Risk Management Trust Fund consists of $530,548 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 5 - Investments Held by Trustee

Investments held by trustee consist of a one year U.S. Treasury Note that matures on June 30, 1999, 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 6 - Liabilities for Unpaid Claims

Risk Management Trust Fund

Liabilities for unpaid claims are estimates 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), represents the estimated liability on reported claims established by the Risk Management department, and;

2. Incurred but not reported (IBNR) reserves includes 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 5.25 percent annual rate of return on future investment income. The liabilities reported at June 30, 1998, for each insurable area follow:

Auto liability	$ 1,077,713
General liability	11,619,674
Workers' compensation	5,303,298
Medical malpractice	12,056,134
Auto physical damage	71,285
Property	244,793
Total	$ 30,372,897

The total estimates of unpaid claim liabilities of $30.4 million at June 30, 1998, increased by approximately $3.1 million from last year's balance of $27.3 million. The reasons for the $3.1 million increase in the estimates of unpaid claim liabilities are as follows:

- In general the reserve should be expected to increase over time due to positive trends in the cost per exposure. The most recent accident year that enters the reserve calculation will tend to cost more per exposure than the previous accident years, which will lead to an increase in the reserve.
- For workers' compensation, the County changed Third Party Administrators (TPA). The new TPA closed several files which would increase the payments. It also appears that the case reserves have been strengthened by the new TPA.
- Data shows a worsening of the County's loss experience in workers' compensation.
- The actual paid loss and allocated loss adjustment expense (ALAE) was better than expected for all combined coverages. As a result, the loss and ALAE reserve as of June 30, 1998, is higher than expected since the actual paid amounts are lower than our projected amounts.

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

	Balance July 1	Current-Year Claims and Changes in Estimates	Claims Payments	Balance June 30
1996-97	$44,688,650	$(8,941,802)	$(8,156,897)	$27,589,951
1997-98	27,589,951	10,949,249	(8,166,303)	30,372,897

Employee Benefits Trust Fund

The liability for medical and short-term disability claims as shown below is based on the prior year's actuarial report and current claims filed. 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, 1998, for each insurable area follow:

Medical	$ 406,239
Short-term disability	87,028
Total	$ 493,267

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
1996-97	$4,738,484	$17,035,602	$(18,109,780)	$3,664,306
1997-98	3,664,306	7,175,112	(10,346,151)	493,267

NOTE 7 – Beginning Fund Equity Restated

The beginning fund equity has been restated for the cumulative effect of the net change of reporting investments at fair value rather than at cost. For the year ended June 30, 1998, the County adopted the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The new standard requires certain investments to be reported at fair value rather than at cost. The amount of restatement for the Risk Management Trust Fund is ($57,294) and for the Employee Benefits Trust Fund is ($10,809). As a result of this adjustment, the July 1, 1997, cash and cash equivalents balance has been restated in the same amounts.

NOTE 8 – Fund Deficit

The County Board of Supervisors has elected not to fund the Risk Management Trust Fund's unpaid claims. Consequently, the Risk Management Trust Fund only billed user departments for operating costs and administrative expenses for the last three fiscal years. This resulted in a fund deficit of $6,544,558 at June 30, 1998. Starting July 1, 1999, Risk Management will begin billing user departments for actuarially determined paid claim estimates.

NOTE 9 - 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 ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The ASRS issues a publicly available 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 ASRS members' and the Funds' contribution rate. For the year ended June 30, 1998, active ASRS members and the Funds were each required by statute to contribute at the actuarially determined rate of 3.54 percent (3.05 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, 1998, 1997, and 1996 were $47,517, $37,647, and $42,026, respectively, which were equal to the required contributions for the year.