Maricopa Managed Care Systems' MHP and ALTCS Funds

Fiscal Year Ended June 30, 2005

Maricopa County, Arizona

www.maricopa.gov

Maricopa Managed Care Systems
MHP and ALTCS Funds
Report on Audit of Financial Statements
June 30, 2005

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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 were engaged to audit the accompanying financial statements of the Maricopa Managed Care Systems' Maricopa Health Plan (MHP) and Arizona Long-Term Care System (ALTCS) Funds as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the Systems' management.

As discussed in Note 1, the Maricopa Managed Care Systems' MHP and ALTCS Funds are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities and major funds of Maricopa County that is attributable to the Systems' MHP and ALTCS Funds.

The Maricopa Managed Care Systems had inadequate internal controls for processing medical claims and accounting for prepayments made to medical providers. As a result, we could not rely on the Systems' financial reporting system to generate reliable information for medical expenses, prepaid expenses, and medical claims payable. Further, the Systems' records did not permit us to apply auditing procedures sufficient to determine whether the amounts reported for medical expenses, prepaid expenses, and medical claims payable in the financial statements were accurate. In addition, these control deficiencies affected the amounts reported for reinsurance revenues, reinsurance receivable, due from other county funds, and due to other county funds.

Since the Maricopa Managed Care Systems did not maintain adequate internal controls for processing medical claims and accounting for prepayments made to medical providers and we were not able to apply auditing procedures to satisfy ourselves as to the amounts reported for medical expenses, prepaid expenses, and medical claims payable, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements of the Maricopa Managed Care Systems' MHP and ALTCS Funds as of and for the year ended June 30, 2005.

As described in Note 1, the Maricopa Managed Care Systems implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, for the year ended June 30, 2005, which represents a change in accounting principle.

Debbie Davenport
Auditor General

November 6, 2006

Maricopa Managed Care Systems
MHP and ALTCS Funds
Statement of Net Assets—Enterprise Funds
June 30, 2005

	MHP Fund	ALTCS Fund
Assets		
Current assets:		
Cash and cash equivalents		$ 12,692,616
Receivables:		
Capitation	$ 8,257,183	4,126,106
Reinsurance	6,653,673	7,752,075
Other	120,424	201,781
Prepaid expenses	9,838,220	5,520,005
Total current assets	24,869,500	30,292,583
Noncurrent assets:		
Capital assets:		
Equipment	3,383,332	6,967,447
Less accumulated depreciation	(3,383,332)	(6,818,285)
Total noncurrent assets		149,162
Total assets	24,869,500	30,441,745
Liabilities		
Current liabilities:		
Medical claims payable	28,900,000	28,509,403
Accounts payable	1,200,544	8,137,784
Accrued liabilities	1,113,200	555,167
Due to other county funds	14,324,346	
Total current liabilities	45,538,090	37,202,354
Net Assets		
Invested in capital assets		149,162
Deficit	(20,668,590)	(6,909,771)
Total deficit	$ (20,668,590)	$ (6,760,609)

See accompanying notes to financial statements

Maricopa Managed Care Systems
MHP and ALTCS Funds
Statement of Revenues, Expenses, and Changes in Fund Net Assets—Enterprise Funds
Year Ended June 30, 2005

	MHP Fund	ALTCS Fund
Operating revenues:		
Capitation	$107,082,742	$212,708,774
Reinsurance	3,892,095	7,506,752
Third party recoveries	490,531	110,232
Hospital supplement	1,028,656	
SOBRA supplement	4,144,146	
HIV-AIDS supplement	1,042,535	358,088
Patient contributions		100,496
Total operating revenues	117,680,705	220,784,342
Operating expenses:		
Hospital inpatient services	36,343,305	
Medical compensation	26,361,473	
Institutional care		101,214,990
Home and community-based services (HCBS)		64,707,923
Acute care		56,891,177
Other medical	53,932,375	2,516,583
Administrative	12,880,729	19,078,650
Depreciation		3,164,273
Total operating expenses	129,517,882	247,573,596
Operating loss	(11,837,177)	(26,789,254)
Nonoperating revenues (expenses):		
Investment income	112,626	489,636
Premium tax	(2,796,131)	(4,604,506)
Total net nonoperating expenses	(2,683,505)	(4,114,870)
Loss before transfers	(14,520,682)	(30,904,124)
Transfers in	5,187,415	6,902,168
Decrease in net assets	(9,333,267)	(24,001,956)
Total net assets (deficit), July 1, 2004	(11,335,323)	17,241,347
Total deficit, June 30, 2005	$ (20,668,590)	$ (6,760,609)

See accompanying notes to financial statements.

Maricopa Managed Care Systems
MHP and ALTCS Funds
Statement of Cash Flows—Enterprise Funds
Year End June 30, 2005

	MHP Fund	ALTCS Fund
Cash flows from operating activities:		
Cash receipts from:		
Contractors	$ 122,674,266	$ 225,759,620
Third party insurers	490,531	110,232
Patients		100,496
Cash payments to:		
Providers for health care services	(124,524,707)	(239,268,058)
Suppliers and other county funds for goods and services	(1,614,741)	(4,272,831)
Employees for services	(9,722,158)	(13,233,695)
Net cash used for operating activities	(12,696,809)	(30,804,236)
Cash flows from noncapital financing activities:		
Cash transfer from County General Fund	5,187,415	6,902,168
Cash payments for premium tax	(2,540,061)	(4,704,196)
Net cash provided by noncapital financing activities	2,647,354	2,197,972
Cash flows from investing activities:		
Interest receipts	112,626	487,545
Net cash provided by investing activities	112,626	487,545
Net decrease in cash and cash equivalents	(9,936,829)	(28,118,719)
Cash and cash equivalents, July 1, 2004	9,936,829	40,811,335
Cash and cash equivalents, June 30, 2005	$ 0	$ 12,692,616
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (11,837,177)	$ (26,789,254)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation		3,164,273
Net changes in assets and liabilities:		
Capitation receivable	1,788,716	1,633,658
Reinsurance receivable	3,695,376	3,552,347
Other receivables	25,881	57,504
Prepaid expenses	(6,227,235)	16,976,293
Due from other county funds	7,421,090	6,076,944
Medical claims payable	728,001	(27,085,484)
Accounts payable	937,622	6,308,258
Accrued liabilities	(385,737)	(1,136,012)
Due to other county funds	(8,843,346)	(13,562,763)
Net cash used for operating activities	$ (12,696,809)	$ (30,804,236)

See accompanying notes to financial statements.

Maricopa Managed Care Systems
MHP and ALTCS Funds
Notes to Financial Statements
June 30, 2005

Note 1 Summary of Significant Accounting Policies

The accounting policies of the Maricopa Managed Care Systems (the Systems) conform to generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board. A summary of the Systems' significant accounting policies follows.

During the year ended June 30, 2005, the Systems implemented the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures.* GASB Statement No. 40 establishes and modifies the risk disclosures about the Systems' deposits and investments. The implementation of GASB Statement No. 40 requires only additional disclosures, and had no effect on reported cash and cash equivalents, net assets, or changes in net assets.

A. Reporting Entity

The Systems contract with the Arizona Health Care Cost Containment System (AHCCCS) Administration to provide health care services to eligible enrollees of the Acute Health Care and Arizona Long-Term Care System (ALTCS) programs. For financial reporting purposes, the Systems comprise the Maricopa Health Plan (MHP) Fund for the Acute Health Care program and the ALTCS Fund for the ALTCS program, which are accounted for as Enterprise Funds of Maricopa County, Arizona, (County) under the direction of administrators contracted by the County Board of Supervisors. However, ultimate fiscal responsibility for the Systems remains with the County. The MHP Fund accounts for both inpatient and outpatient medical and nursing services provided to eligible enrollees of the Acute Health Care program. The ALTCS Fund accounts for inpatient and outpatient medical and nursing services in addition to managed institutional, home, and community-based long-term care services provided to eligible ALTCS program enrollees. The Systems receive monthly capitation payments from the AHCCCS Administration for all eligible enrollees under the respective Acute Health Care and ALTCS programs.

B. Fund Accounting

The Systems' accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Systems' 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. The Systems' financial transactions are recorded as enterprise funds since their operations are financed and operated in a manner similar to private business enterprises, in which the intent of the Board of Supervisors is that the costs (expenses, including depreciation) of providing goods or services to the Systems' enrollees on a continuing basis be financed or recovered primarily through user charges.

C. Basis of Presentation and Accounting

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

A statement of net assets provides information about the assets, liabilities, and net assets at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external donor restrictions or availability of assets to satisfy the Systems' 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 contracts and other resources that have been externally restricted for health care purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

A statement of revenues, expenses, and changes in fund net assets provides information about the Systems' financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including transfers. Generally, capitation; reinsurance; third party recoveries; hospital, SOBRA and HIV-AIDS supplements; and patient contributions are considered to be operating revenues. Other revenues used for health care services, such as investment income, are not generated from operations and are considered to be non-operating revenues. Operating expenses include the costs of providing health care services, administrative expenses, and depreciation on capital assets. Premium tax is not for health care services and is considered to be a nonoperating expense.

A statement of cash flows provides information about the Systems' sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, noncapital financing, capital financing, or investing.

The financial statements 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 Systems 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 Systems have chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

D. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Maricopa County Treasurer.

E. Capital Assets

Capital assets are recorded at actual cost and the capitalization threshold is $5,000 or more. Depreciation of such assets 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 equipment are 3 to 8 years.

F. Compensated Absences

Compensated absences consist of personal leave and a calculated amount of family medical leave as defined by the Federal Family and Medical Leave Act (FMLA), earned by employees based on services already rendered. The vested amount of personal leave is reported as an accrued liability in the MHP and ALTCS Funds' financial statements. Employees may accumulate up to 240 hours of personal leave depending on years of service, but any personal hours in excess of the maximum amount that are unused by the calendar year-end are converted to family medical leave. Generally, family medical leave benefits provide for qualifying FMLA events and are cumulative but do not vest with employees and therefore, are not accrued. However, upon retirement, employees with accumulated family medical leave in excess of 1,000 hours are entitled to a $3,000 bonus. The total amount of such bonuses is immaterial, and therefore it is not reported in the accrued liability.

G. Investment Income

Investment income is composed of interest and net changes in the fair value of applicable investments.

Note 2 Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Maricopa County Treasurer and represent a portion of the County Treasurer's investment pool portfolios. There is no oversight provided for the County Treasurer's investment pool, and the pool's structure does not provide for shares. The Systems' portion in the pool is not identified with specific investments.

Credit risk—The Systems follow the County's policy to preserve the principal value and the interest income of an investment. The County can invest in obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, or instrumentalities. The County can also invest in commercial paper and corporate bonds with ratings that meet the statutory requirements specified below. At June 30, 2005, the Systems' investments consisted of monies invested in the Maricopa County Treasurer's Investment Pool which is unrated.

Interest rate risk—It is County's policy to hold investments to maturity, where practical, and avoid any loss on investments resulting from an early sale or retirement of an investment. Additionally, securities should be invested for a shorter duration, where applicable. At June 30, 2005, the Systems had investments of $12,692,616 in the Maricopa County Treasurer's Investment Pool with a weighted average maturity of 440 days.

Legal Provisions—Arizona Revised Statutes authorize counties to invest public monies in the State Treasurer's investment pool; obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations, or instrumentalities; specified state and local government bonds; interest earning investments such as savings accounts, certificates of deposit, and repurchase agreements in eligible depositories; and specified commercial paper, bonds, debentures, and notes issued by corporations organized and doing business in the United States. In addition, the County Treasurer may invest trust funds in fixed income securities of corporations doing business in the United States or District of Columbia.

Credit risk—Statutes have the following requirements for credit risk:

1. Commercial paper must be rated P1 by Moody's investors service or A1 or better by Standard and Poor's rating service.
2. Corporate bonds, debentures, and notes must be rated A or better by Moody's investors service or Standard and Poor's rating service.
3. Fixed income securities must carry one of the two highest ratings by Moody's investors service and Standard and Poor's rating service. If only one of the above-mentioned services rates the security, it must carry the highest rating of that service.

Custodial credit risk—Statutes require collateral for demand deposits, certificates of deposit, and repurchase agreements at 101 percent of all deposits not covered by federal depository insurance.

Concentration of credit risk—Statutes do not include any requirements for concentration of credit risk.

Interest rate risk—Statutes require that public monies invested in securities and deposits have a maximum maturity of 5 years and that public operating fund monies invested in securities and deposits have a maximum of 3 years. Investments in repurchase agreements must have a maximum maturity of 180 days.

Foreign currency risk— Statutes do not allow foreign investments.

Note 3 Receivables

Capitation receivables result from revenues that are attributable to the year ended June 30, 2005, but not received until a subsequent fiscal year. Reinsurance receivables result from additional payments due from AHCCCS to the Systems for certain enrollees whose medical expenses paid by the Systems during the fiscal year were in excess of specified deductible limits.

Note 4 Prepaid Expenses

Prepaid expenses include advance payments and claims overpayments made to providers. During fiscal year 2005, the Systems advanced

$47,464,589 to their providers for the Acute Health Care and ALTCS programs. In order to allocate the advances to the MHP and ALTCS Funds, the Systems estimated the amounts attributable to each fund based on the fund's experience with the providers.

Prepaid expenses at June 30, 2005, consist of $9,838,220 for the MHP Fund and $5,520,005 for the ALTCS Fund.

Note 5 Capital Assets

Capital asset activity for the year ended June 30, 2005, was as follows (in thousands):

	July 1, 2004	Decreases	June 30, 2005
MHP Fund			
Equipment	$ 3,383	$ 0	$ 3,383
Accumulated depreciation	(3,383)	0	(3,383)
Total capital assets, net	$ 0	$ 0	$ 0
ALTCS Fund			
Equipment	$ 6,968	$ 0	$ 6,968
Accumulated depreciation	(3,654)	(3,165)	(6,819)
Total capital assets, net	$ 3,314	$(3,165)	$ 149

Note 6 Medical Claims Payable

At the time the calculations for this report were prepared, paid claim information through January 2006 was available. The following table details the medical claims payable at June 30, 2005 (in thousands):

	MHP Fund	**ALTCS Fund**
Claims payments subsequent to year-end	$24,964	$24,656
Additional accrual	3,936	3,853
Total medical claims payable	$28,900	$28,509

Note 7 Due To Other County Funds

At June 30, 2005, the MHP Fund owed $14,324,346 to the Maricopa County General Fund for monies received to temporarily eliminate cash overdrafts.

Note 8 Maricopa County Equity Transfers

During fiscal year 2005, the MHP and ALTCS Funds experienced a negative equity per member position and AHCCCS requires the Systems to maintain a ratio of $150 equity per AHCCCS Acute Health Care member and $2,000 equity per ALTCS member. As a result, the County transferred $5,187,415 to the MHP Fund and $6,902,168 to the ALTCS Fund in order for the Systems to meet the minimum requirements.

Note 9 Risk Management

The Systems are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Systems are a participant in the County's self-insurance program and in the opinion of the Systems' management, any unfavorable outcomes from these risks would be covered by that self-insurance program. Accordingly, the Systems have no risk of loss beyond adjustments to future years' premium payments to the County's self-insurance program. All estimated losses for unsettled claims and actions of the County are determined on an actuarial basis and are included in the *Maricopa County Comprehensive Annual Financial Report.*

Note 10 Retirement Plan

Plan Description – The Plans 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 Arizona Revised Statutes Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes its financial statements and required supplementary information. A recent report may be obtained by writing the Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, AZ 85012-3910 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 Plans' contribution rates. For the year ended June 30, 2005, active plan members and the Plans were each required by statute to contribute at the actuarially determined rate of 5.7 percent (5.2 percent retirement and 0.5 percent long-term disability) of the members' annual covered payroll. The Plans' contributions to the ASRS for the years ended June 30, 2005, 2004, and 2003 were $776, $818, and $322 (in thousands), respectively, which were equal to the required contributions for the year.

Note 11 Subsequent Events

On May 25, 2005, the Maricopa County Board of Supervisors approved the process to transfer the AHCCCS Acute Health Care program and close the ALTCS program by September 30, 2005. On August 29, 2005, the Maricopa County Board of Supervisors approved the transfer and assignment of the AHCCCS Acute Health Care program to the Maricopa County Special Health Care District (District) effective October 1, 2005. All liabilities prior to the transfer to the District will remain with Maricopa County. In addition, the County discontinued the AHCCCS ALTCS program effective September 30, 2005, and all associated liabilities will remain with Maricopa County.