

MARICOPA COUNTY, ARIZONA
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Report on Audit of Financial Statements
June 30, 2001

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Report on Audit of Financial Statements
June 30, 2001

<u>Table of Contents</u>	<u>Page</u>
Independent Auditors' Report	1
Balance Sheets—Internal Service Funds	2
Statements of Revenues, Expenses, and Changes in Fund Equity—Internal Service Funds	3
Statements of Cash Flows—Internal Service Funds	5
Notes to Financial Statements	6



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 Maricopa County's Risk Management and Employee Benefits Trust Funds as of and for the year ended June 30, 2001, 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 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 U.S. 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, 2001, and the results of their operations and cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2, the County reclassified certain activities previously reported in the Employee Benefits Trust Fund to the County's General and Agency Funds, which constitutes a change in reporting entity. This resulted in a significant decrease in revenues and expenses reported in the Employee Benefits Trust Fund.

As of July 1, 2000, the County increased the capitalization threshold for fixed assets. As a change in the application of an accounting principle, the beginning fund equity balances were restated for the Risk Management and Employee Benefits Trust Funds, as discussed in Note 3.

Debbie Davenport
Auditor General

October 12, 2001

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Balance Sheets—Internal Service Funds
June 30, 2001

	Risk Management	Employee Benefits
Assets		
Current assets:		
Cash and cash equivalents-		
Risk management	\$ 17,184,582	
Environmental insurance claims recovery	1,759,830	
Employee benefits		\$ 3,654,113
Interest receivable	209,625	43,958
Prepaid insurance	697,923	2,000
Total current assets	19,851,960	3,700,071
Restricted assets:		
Investments held by trustee	2,429,908	
Total restricted assets	2,429,908	
Machinery and equipment	74,554	291,533
Less: accumulated depreciation	(32,926)	(17,062)
Net machinery and equipment	41,628	274,471
Total assets	\$ 22,323,496	\$ 3,974,542
Liabilities and fund equity		
Liabilities:		
Accounts payable	\$ 499,267	\$ 81,799
Accrued liabilities	197	218,305
Employee compensation payable	82,087	
Deposits held for others		221,974
Reported but unpaid claims:		
Auto liability	345,460	
General liability	10,960,299	
Workers' compensation	8,003,772	
Medical malpractice	2,757,761	
Auto physical damage	65,921	
Property	161,816	
Incurred but not reported claims:		
Auto liability	151,084	
General liability	6,658,504	
Workers' compensation	186,809	
Medical malpractice	11,277,618	
Employee medical		52,859
Short-term disability		87,028
Total liabilities	41,150,595	661,965
Fund equity:		
Contributed capital	2,886,478	30,445
Retained earnings (accumulated deficit)	(21,713,577)	3,282,132
Total fund equity (deficit)	(18,827,099)	3,312,577
Total liabilities and fund equity	\$ 22,323,496	\$ 3,974,542

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, 2001

	Risk Management	Employee Benefits
Operating revenues:		
Charges for services	\$ 19,227,729	
Insurance recoveries	84,266	
County and employee premiums		\$ 3,433,082
Total operating revenues	19,311,995	3,433,082
Operating expenses:		
Personal services	1,058,781	
Supplies and services	460,518	
Brokers' fees	39,000	
Consulting and management fees	324,525	
Claims administration service fees	207,751	201,203
Legal expenses	5,594,105	
Claims and insurance:		
Auto liability claims paid	133,405	
Auto liability claims reported increase in estimate	143,756	
Auto liability IBNR claims decrease in estimate	(504,576)	
Total auto liability	(227,415)	
General liability claims paid	680,693	
General liability claims reported decrease in estimate	(624,967)	
General liability IBNR claims increase in estimate	1,583,681	
Total general liability	1,639,407	
Workers' compensation claims paid	3,275,854	
Workers' compensation claims reported decrease in estimate	(487,893)	
Workers' compensation IBNR claims increase in estimate	290,010	
Total workers' compensation	3,077,971	
Medical malpractice claims paid	4,304,303	
Medical malpractice claims reported decrease in estimate	(5,189,668)	
Medical malpractice IBNR claims increase in estimate	2,412,858	
Total medical malpractice	1,527,493	
Auto physical damage claims paid	187,208	
Auto physical damage claims reported decrease in estimate	(872)	
Total auto physical damage	186,336	
Property claims paid	62,074	
Property claims reported decrease in estimate	(83,909)	
Total property	(21,835)	
Employee medical claims paid		29,280
Employee medical IBNR claims decrease in estimate		(29,280)
Total employee medical		0
Short-term disability claims paid		924,104
Short-term disability IBNR claims increase (decrease) in estimate		0
Total short-term disability		924,104
Unemployment claims	435,338	

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, 2001
(Continued)

	Risk Management	Employee Benefits
Dental claims		\$ 1,595,692
Environmental contingency	\$ 225,000	
General liability insurance premiums	568,963	
Workers' compensation insurance premiums	181,670	
Individual blanket bonds	22,940	
Property insurance premiums	324,084	
Malpractice insurance premiums	694,235	
Health insurance		244,868
Depreciation	14,729	7,822
Total operating expenses	16,333,596	2,973,689
Operating income	2,978,399	459,393
Nonoperating revenues (expenses):		
Investment income	1,328,638	308,928
Loss on disposal of machinery and equipment	(15,773)	(8,912)
Net nonoperating revenues	1,312,865	300,016
Net income	4,291,264	759,409
Fund equity (deficit), July 1, 2000, as restated	(23,118,363)	2,553,168
Fund equity (deficit), June 30, 2001	\$ (18,827,099)	\$ 3,312,577

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, 2001

	Risk Management	Employee Benefits
Cash flows from operating activities:		
Operating income	\$ 2,978,399	\$ 459,393
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	14,729	7,822
Net change in liability for incurred but not reported claims	3,781,973	(29,280)
Changes in assets and liabilities:		
Increase in:		
Prepaid insurance	(47,668)	
Accounts payable		45,114
Accrued liabilities	197	
Deposits held for others		68,716
Decrease in:		
Due from other governmental units		19,342
Accounts payable	(272,551)	
Accrued liabilities		(710,980)
Employee compensation payable	(2,463)	(56,424)
Liability for reported but unpaid claims	(6,243,553)	
Net cash provided by (used for) operating activities	209,063	(196,297)
Cash flows from capital and related financing activities:		
Acquisition of machinery and equipment	(22,344)	(245,426)
Net cash used for capital and related financing activities	(22,344)	(245,426)
Cash flows from investing activities:		
Interest on investments	1,308,737	307,273
Proceeds from sale of investments held by trustee	2,347,238	
Purchase of investments held by trustee	(2,429,908)	
Net cash provided by investing activities	1,226,067	307,273
Net increase in cash and cash equivalents	1,412,786	(134,450)
Cash and cash equivalents, July 1, 2000	17,531,626	3,788,563
Cash and cash equivalents, June 30, 2001	\$ 18,944,412	\$ 3,654,113
Noncash investing, capital, and financing activities:		
Disposal of machinery and equipment	\$ (17,307)	\$ (9,153)
Elimination of accumulated depreciation related to disposal	1,534	241
Loss on disposal of machinery and equipment	15,773	8,912
Deletion of equipment due to change in capitalization policy	(41,176)	(41,709)
Deletion of accumulated depreciation due to change in capitalization policy	25,760	18,045
Restatement of July 1, 2000, fund equity due to change in capitalization policy	15,416	23,664

See accompanying notes to financial statements.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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 U.S. 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, short-term disability, and dental) 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.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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 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 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 - Reporting Changes

As of July 1, 2000, the County reclassified the nonself-insured activity from the Employee Benefits Trust Fund, to the County's Special Purpose Agency Fund. In addition, as of July 1, 2000, the Employee Benefits Office became funded as a department of the General Fund; previously it was operated through the Employee Benefits Trust Fund. The result was a decrease in revenues and expenses from the previous fiscal year of approximately \$43 million in the Employee Benefits Trust Fund. The July 1, 2000, fund equity of the Employee Benefits Trust Fund was not restated for the reclassification of the activities as Arizona Revised Statutes (A.R.S.) require that the monies must remain on deposit in the trust fund until expended.

NOTE 3 – Beginning Fund Equity Restated

As of July 1, 2000, the County increased the machinery and equipment capitalization threshold to \$5,000 and all asset items under that level were no longer capitalized. The write-off of assets was treated as a reduction in the beginning retained earnings of the Funds. The beginning fund equity (deficit) balances in the Funds were restated as follows:

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

	Risk Management	Employee Benefits
Fund equity (deficit) at June 30, 2000, as previously reported	\$ (23,102,947)	\$ 2,576,832
Net change in the fixed asset capitalization threshold to \$5,000	(15,416)	(23,664)
Fund equity (deficit) at July 1, 2000, as restated	\$ (23,118,363)	\$ 2,553,168

NOTE 4 - Prepaid Insurance

Prepaid insurance for the Risk Management Trust Fund consists of \$617,923 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, 2002, 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 - 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 7 - 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.

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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 2000-01:

<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		599,593,869
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
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:

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

1. Reported but unpaid claims (RUC), 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 5.95 percent annual rate of return on future investment income.

The liabilities reported at June 30, 2001, for each insurable area follow:

Auto liability	\$ 496,544
General liability	17,618,803
Workers' compensation	8,190,581
Medical malpractice	14,035,379
Auto physical damage	65,921
Property	161,816
Total	\$ 40,569,044

The total estimates of unpaid claim liabilities of \$40.6 million at June 30, 2001, decreased by approximately \$2.5 million from last year's balance of \$43.0 million. A significant reason for this decrease was due to medical malpractice since the physicians and surgeons at the County hospital obtain their own malpractice insurance coverage.

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

	Balance <u>July 1</u>	Current-Year Claims and Changes in <u>Estimates</u>	Claims <u>Payments</u>	Balance <u>June 30</u>
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
2000-01	43,030,624	6,181,957	(8,643,537)	40,569,044

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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 through 2000-01. 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, 2001, for each insurable area follow:

Employee medical	\$ 52,859
Short-term disability	87,028
Total	\$ 139,887

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

	Balance <u>July 1</u>	Current-Year Claims and Changes in <u>Estimates</u>	Claims <u>Payments</u>	Balance <u>June 30</u>
1998-99	\$ 493,267	\$ 442,472	\$ (759,620)	\$ 176,119
1999-00	176,119	696,724	(703,676)	169,167
2000-01	169,167	924,104	(953,384)	139,887

NOTE 8 - 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 \$23,321,519 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, 2001, the fund deficit has been reduced to \$18,827,099.

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. Benefits are established by state statute and generally provide retirement, death, long-term disability,

MARICOPA COUNTY
RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS
Notes to Financial Statements
June 30, 2001

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.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and the Funds' contribution rates. For the year ended June 30, 2001, 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, 2001, 2000, and 1999 were \$23,909, \$31,546, and \$47,554 respectively, which were equal to the required contributions for the year.