

2014

Health Benefit Trust Internal Service Fund



Pima County, Arizona
For the Fiscal Year Ended June 30, 2014

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
June 30, 2014

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INDEPENDENT AUDITOR'S REPORT

The Board of Supervisors
of Pima County, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of the Health Benefit Self Insurance Trust Fund, an internal service fund of Pima County, Arizona, as of and for the year ended June 30, 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Health Benefit Self Insurance Trust Fund, an internal service fund of Pima County, Arizona, as of June 30, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1A, the financial statements present only the Health Benefit Self Insurance Trust Fund and do not purport to, and do not present fairly the financial position of Pima County, Arizona as of June 30, 2014, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2014, on our consideration of Health Benefit Self Insurance Trust Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Health Benefit Self Insurance Trust Fund's internal control over financial reporting and compliance.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
CPAs and Business Consultants

October 14, 2014

PIMA COUNTY, ARIZONA
 Health Benefit Self Insurance Trust Fund
 Statement of Net Position
 June 30, 2014

Assets

Current assets:

Cash and cash equivalents	\$	21,627,651
Interest receivable		13,350
Accounts receivable		2,846,556
		24,487,557
Total current assets		24,487,557

Total assets		24,487,557
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Liabilities

Current liabilities:

Accounts payable		132,496
Accrued employee compensation		41,774
Due to other funds		29,354
Reported but unpaid losses, current portion		582,090
Incurred but not reported losses, current portion		5,917,910
		6,703,624
Total current liabilities		6,703,624

Noncurrent liabilities:

Compensated absences payable		45,933
Loan payable		10,000,000
Reported but unpaid losses		17,910
Incurred but not reported losses		182,090
		10,245,933
Total noncurrent liabilities		10,245,933

Total liabilities		16,949,557
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Net position

Restricted for:

Healthcare		7,538,000
		7,538,000

Total net position	\$	7,538,000
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PIMA COUNTY, ARIZONA
 Health Benefit Self Insurance Trust Fund
 Statement of Revenues, Expenses and Changes in Net Position
 Year Ended June 30, 2014

Operating revenues:	
Charges for services	\$ 63,030,898
Other	1,271,951
	<u>1,271,951</u>
Total operating revenues	64,302,849
	<u>64,302,849</u>
Operating expenses:	
Employee compensation	1,098,726
Operating supplies	108,714
Medical claims	47,160,898
Insurance premiums	5,213,631
General and administrative	1,018,071
Professional services	2,578,388
	<u>2,578,388</u>
Total operating expenses	57,178,428
	<u>57,178,428</u>
Operating income	7,124,421
	<u>7,124,421</u>
Nonoperating revenues:	
Investment income	59,362
	<u>59,362</u>
Total nonoperating revenues:	59,362
	<u>59,362</u>
Income before transfers:	7,183,783
Transfers in	3,854,217
Transfers (out)	(3,500,000)
	<u>(3,500,000)</u>
Change in net position	7,538,000
Net position, July 1, 2013	
	<u></u>
Net position, June 30, 2014	\$ 7,538,000
	<u><u>\$ 7,538,000</u></u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
Statement of Cash Flows
Year Ended June 30, 2014

Cash flow from operating activities:	
Receipts from other Pima County funds for goods and services	\$ 60,184,342
Receipts from miscellaneous operations	1,271,951
Payments to suppliers for goods and services	(7,774,781)
Payments to other Pima County funds for goods and services	(1,233,840)
Payments for medical claims	(40,460,898)
Payments to employees	(788,706)
	<hr/>
Net cash provided by operating activities	11,198,068
	<hr/>
Cash flows from noncapital financing activities:	
Transfers with other Pima County funds	354,217
Loans with other Pima County funds	10,029,354
	<hr/>
Net cash provided by noncapital financing activities	10,383,571
	<hr/>
Cash flows from investing activities:	
Interest received on investments	46,012
	<hr/>
Net cash provided by investing activities	46,012
	<hr/>
Net increase in cash and cash equivalents	21,627,651
Cash and cash equivalents, July 1, 2013	
Cash and cash equivalents, June 30, 2014	<hr/> <hr/> \$ 21,627,651

(continued)

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
Statement of Cash Flows
Year Ended June 30, 2014

(continued)

**Reconciliation of operating income to net cash
provided by operating activities**

Operating income	\$ 7,124,421
Adjustments to reconcile operating income to net cash provided by operating activities:	
Changes in assets and liabilities:	
Decrease (increase) in assets:	
Accounts receivable	(2,846,556)
Increase (decrease) in liabilities:	
Accounts payable	132,496
Reported but unpaid losses	600,000
Incurred but not reported losses	6,100,000
Other liabilities	<u>87,707</u>
Net cash provided by operating activities	<u><u>\$ 11,198,068</u></u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
Notes to Financial Statements
June 30, 2014

Note 1 - Summary of Significant Accounting Policies

The accounting policies of Pima County (County) and its Health Benefit Self Insurance Trust Fund (Fund) conform to U.S. generally accepted accounting principles (GAAP) applicable to governmental units as promulgated by the Governmental Accounting Standards Board (GASB) and the regulatory requirements of the State of Arizona. A summary of the County's significant accounting policies affecting the Fund follows.

A. Reporting Entity

The Fund is accounted for as an internal services fund of Pima County, Arizona, and the ultimate financial accountability for the Fund remains with Pima County. The Trust fund is a self-insured medical plan for Pima County employees and their dependents. The Fund is responsible for collecting employer and employee medical premiums through payroll deductions and reimbursing Aetna, acting as the Third Party Administrator, for the payment of the medical claims. The premiums collected include amounts for medical, dental, vision, short-term disability and life insurance coverage. A five member Board of Trustees is responsible to the Pima County Board of Supervisors for oversight of the Trust. The Board of Trustees meets quarterly.

The financial statements present only the Health Benefit Self Insurance Trust Fund as one of the funds of Pima County and are not intended to present the balances and activity of Pima County in its entirety.

B. Fund Accounting

The Fund's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Fund's 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, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, and expenses.

The Fund's financial transactions are recorded and reported as an internal services fund because its operations are financed and operated in a manner similar to private business enterprises. It is the intent of the Board of Supervisors that the costs and claims incurred by the Fund on a continuing basis be financed primarily through payroll deducted employee and employer medical insurance premiums.

C. Basis of Accounting

Basis of accounting relates to the timing of the measurements made, and determines when revenues, expenses and assets, deferred outflows of resources, liabilities and deferred inflows of resources are recognized in the accounts and reported in the financial statements. The financial statements of the Fund are reported using the economic resources measurement focus and are presented on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when a liability is incurred, regardless of the timing of the related cash flow. When both restricted and unrestricted components of net position are available to finance Fund expenses, restricted resources are used before unrestricted resources.

D. Basis of Presentation

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

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
Notes to Financial Statements
June 30, 2014

Note 1 - Summary of Significant Accounting Policies (continued)

A statement of net position provides information about the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the Fund at the end of the year. Assets and liabilities are classified as either current or noncurrent and deferred outflows and inflows of resources, when applicable, are separately reported on the statement of net position. Net position is classified according to external restrictions or availability of assets to satisfy the Fund's obligations. Net investment in capital assets represents the cost of capital assets, net of accumulated depreciation. Restricted net position encompasses grants, contracts, and other resources that have been externally restricted for specific purposes. Unrestricted net position includes the remaining component of net position, including the portion that has been designated by management to be used for other than general operating purposes.

A statement of revenues, expenses and changes in net position provides information about the Fund's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net position are reported including capital contributions and transfers. Generally, charges for services and other revenue for premium rebates, stop loss reinsurance and short-term disability insurance are considered to be operating revenues. Other revenues, such as investment income, are not generated from operations and are considered to be non-operating revenues. Operating expenses include medical claims, insurance premiums and consultants and professional services.

A statement of cash flows provides information about the Fund's 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 and related financing, or investing.

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, cash on deposit with the Pima County Treasurer, investments with the State Treasurer, and deposits held in escrow accounts from both restricted and unrestricted sources. Unrestricted cash and cash equivalents consist of cash on hand, cash and investments held by the Pima County Treasurer in an investment pool, and investments with the State Treasurer. All investments are stated at fair market value.

F. Accounts Receivable

Accounts receivable consist primarily of medical premium amounts deducted from employee compensation, together with the employer contribution, not yet transferred to the fund from the payroll system.

G. Capital Assets

The Fund has no capital assets.

H. Compensated Absences

Compensated absences consist of vacation leave and a calculated amount of sick leave earned by employees based on services already rendered.

Employees may accumulate up to 240 hours of vacation depending upon years of services, but any vacation hours in excess of the maximum amount that are unused at year-end are forfeited. Upon termination of employment, all unused and un-forfeited vacation benefits are paid to employees. Accordingly, vacation benefits are accrued as a liability in the financial statements.

PIMA COUNTY, ARIZONA
Health Benefit Self Insurance Trust Fund
Notes to Financial Statements
June 30, 2014

Note 1 - Summary of Significant Accounting Policies (continued)

Employees may accumulate up to 1,920 of sick hours. Generally, sick leave benefits provide for ordinary sick pay and are cumulative but are forfeited upon termination of employment. Sick leave benefits do not vest with employees; however employees who are eligible to retire from County service into the Arizona State Retirement System, may request sick leave be converted to annual leave, on a predetermined conversion basis. An estimate of those retirement payouts is accrued as a liability.

Note 2 - Cash and Investments

Cash and cash investments consist of \$500 in a Chase HSA Reserve outside bank account used to transfer employee payroll contributions to individual employee accounts, and \$11,597,798 of cash on deposit with the County Treasurer and available on demand. The Treasurer pools these deposits with other County monies for investment within the County Treasurer's pool. The Fund's deposits are included in the Treasurer's investment pool but are not identified with specific investments. Additionally, there is \$10,029,353 in the State's LGIP Pool 500.

Credit Risk—Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The County does not have a formal investment policy with respect to credit risk. The Pima County Treasurer's investment pool is unrated.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect an investment's fair value. The County does not have a formal investment policy with respect to interest rate risk. The Pima County Treasurer's investment pool had a weighted average maturity of 525 days and the State's LGIP Pool 500 had a weighted average maturity of 1.64 years at June 30, 2014.

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 maturity of 3 years. Investments in repurchase agreements must have a maximum maturity of 180 days.

PIMA COUNTY, ARIZONA
 Health Benefit Self Insurance Trust Fund
 Notes to Financial Statements
 June 30, 2014

Note 2 - Cash and Investments (continued)

Foreign currency risk—Statutes do not allow foreign investments.

Note 3 - Claims, Judgments and Risk Management

The management of the Fund establishes claim liabilities from an annual actuarial report for Projected Unpaid Claim Liability. The actuarial report estimates the Incurred But Not Reported (IBNR) and the Incurred But Not Paid (IBNP) liabilities both current and noncurrent. The computations are made using a variety of actuarial methods and techniques including the exposure approach and completion factors. Adjustments to the claim liabilities are charged or credited to expense in the periods in which claims are made. The Fund has reinsurance (stop-loss) coverage for excessive medical claim losses.

Changes in the Fund's claims liability amount for the year ended June 30, 2014 is as follows:

	2014
Claims liability - beginning	
Current-year claims and changes in estimates	47,160,898
Claims payment	(40,460,898)
Claims liability balance - ending	6,700,000

	Balance July 1, 2013	Additions	Reductions	Balance June 30, 2014	Due within 1 year
Incurred but not reported (IBNR)		46,560,898	(40,460,898)	6,100,000	5,917,910
Reported but unpaid losses (IBNP)		600,000		600,000	582,090
Total		47,160,898	(40,460,898)	6,700,000	6,500,000

The Fund is also exposed to various risks of loss related to torts; errors and omissions; injuries to employees; and natural disasters. The Fund is a participant in Pima County's self-insurance program, and in the opinion of the Fund's management, that program would cover any unfavorable outcomes from these risks. Accordingly, the Fund has no risk of loss beyond adjustments to future years' overhead payments to Pima County. All estimated losses for unsettled claims and actions of Pima County are determined on an actuarial basis and are included in the Pima County Comprehensive Annual Financial Report.

Note 4 - Related Party Transactions

Administrative and Fiscal Services—For the year ended June 30, 2014, the Fund incurred expenses from Pima County for a variety of administrative and fiscal services totaling \$1,233,841. Of that amount, \$222,314 was for inter-department salaries charged in, \$115 was for motor pool charges, \$1,000,000 was for the allocation of overhead, \$7,204 was for telephone, and \$4,208 was for printing and microfilming.

Note 5 - Due To/From Other funds

Due to other Pima County funds represents payables for interest earned on an interfund loan payable of \$10,000,000 from the Self Insurance Risk Fund. The loan is a reserve for the Health Benefit Self Insurance Trust Fund until it can

PIMA COUNTY, ARIZONA
 Health Benefit Self Insurance Trust Fund
 Notes to Financial Statements
 June 30, 2014

Note 5 - Due To/From Other funds (continued)

establish its own reserve and was deposited in the State’s LGIP Pool 500 account under the Trust’s name. However, all interest earned on the account is payable to the Self Insurance Risk Fund. At June 30, 2014, the due to other funds was \$29,354 in interest due to the Self Insurance Risk Fund.

Note 6 - Retirement Plan

Plan Description—The Fund contributes to a cost-sharing, multiple-employer defined benefit pension plan; a cost-sharing multiple employer defined benefit health insurance premium plan; and a cost-sharing, multiple-employer defined benefit long-term disability plan administered by the *Arizona State Retirement System* (ASRS) that covers employees of the State of Arizona and employees of participating political subdivisions and school districts.

Benefits are established by state statute and generally provide retirement, long-term disability, and health insurance premium benefits, including death and survivor benefits. The retirement benefits are generally paid at a percentage, based on years of service, of the retiree’s average compensation. Long-term disability benefits vary by circumstance, but generally pay a percentage of the employee’s monthly compensation. Health insurance premium benefits are generally paid as a flat dollar amount per month towards the retiree’s health care insurance premiums, in amounts based on whether the benefit is for the retiree or for the retiree and his or her spouse. 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.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members’ and the County’s contribution rates. For the year ended June 30, 2014, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.54 percent (11.30 percent for retirement and 0.24 percent for long-term disability) of the members’ annual covered payroll and the County was required by statute to contribute at the actuarially determined rate of 11.30 percent (10.70 percent for retirement, 0.60 percent for health insurance premium) and 0.24 percent for long-term disability of the members’ annual covered payroll.

The County’s contributions for the current and first year, which are equal to the required contributions, were as follows:

<u>Years ended June 30,</u>	<u>Retirement Fund</u>	<u>Health Benefit Supplement Fund</u>	<u>Long-Term Disability Fund</u>
2014	\$ 65,191	\$ 3,655	\$ 1,462

The financial statements for the ASRS plan can be obtained by contacting ASRS at:

3300 N. Central Avenue
 Phoenix, AZ 85012
 P.O. Box 33910
 Phoenix, AZ 85067-3910
 (602) 240-2000 or 1-800- 621-3778
www.azasrs.gov

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance with
*Government Auditing Standards***

Independent Auditor's Report

The Board of Supervisors
of Pima County, Arizona

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the of Health Benefit Self Insurance Trust Fund, an internal service fund of Pima County, Arizona, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise Health Benefit Self Insurance Trust Fund's basic financial statements, and have issued our report thereon dated October 14, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Health Benefit Self Insurance Trust Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Health Benefit Self Insurance Trust Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of Health Benefit Self Insurance Trust Fund's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Health Benefit Self Insurance Trust Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
CPAs and Business Consultants

October 14, 2014