



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Financial Statement Audit

Pima County

Self-Insurance Trust

Internal Service Fund

Year Ended June 30, 2004



Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.



Copies of the Auditor General's reports are free.
You may request them by contacting us at:

Office of the Auditor General

2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:

www.auditorgen.state.az.us

Pima County
Self-Insurance Trust Internal Service Fund
Report on Audit of Financial Statements
Year Ended June 30, 2004

Table of Contents	Page
Independent Auditors' Report	1
Statement of Net Assets	2
Statement of Revenues, Expenses, and Changes in Fund Net Assets	3
Statement of Cash Flows	4
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
Pima County, Arizona

We have audited the accompanying financial statements of the Pima County Self-Insurance Trust Internal Service Fund as of and for the year ended June 30, 2004, 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 Pima County Self-Insurance Trust Internal Service Fund's financial statements are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the governmental activities, business-type activities, and aggregate remaining fund information of the County that is attributable to the Pima County Self-Insurance Trust Internal Service Fund. They do not purport to, and do not, present fairly the financial position of Pima County as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pima County Self-Insurance Trust Internal Service Fund as of June 30, 2004, and the changes in its financial position and its cash flows, for the year then ended in conformity with U.S. generally accepted accounting principles.

Debbie Davenport
Auditor General

November 15, 2004

Pima County
 Self-Insurance Trust Internal Service Fund
 Statement of Net Assets
 June 30, 2004

Assets

Current assets:	
Cash and cash equivalents	\$39,386,487
Interest receivable	90,817
Due from other funds	16,196
Accounts receivable	152,789
Prepaid expenses	<u>914,393</u>
Total current assets	<u>40,560,682</u>
Noncurrent assets:	
Capital assets:	
Land	592,353
Equipment	93,842
Less accumulated depreciation	<u>81,931</u>
Total capital assets, net	<u>604,264</u>
Total assets	<u>41,164,946</u>

Liabilities

Current liabilities:	
Accounts payable	675,010
Accrued employee compensation	119,989
Due to other funds	29,723
Reported but unpaid losses, current portion	2,441,167
Incurred but not reported losses, current portion	<u>3,267,660</u>
Total current liabilities	<u>6,533,549</u>
Noncurrent liabilities:	
Reported but unpaid losses	8,401,380
Incurred but not reported losses	<u>11,585,340</u>
Total noncurrent liabilities	<u>19,986,720</u>
Total liabilities	<u>26,520,269</u>

Net Assets

Invested in capital assets	604,264
Unrestricted	<u>14,040,413</u>
Total net assets	<u>\$14,644,677</u>

See accompanying notes to financial statements.

Pima County
Self-Insurance Trust Internal Service Fund
Statement of Revenues, Expenses,
and Changes in Fund Net Assets
Year Ended June 30, 2004

Operating revenues:	
Charges for services	\$15,322,748
Other	<u>601,328</u>
Total operating revenues	<u>15,924,076</u>
Operating expenses:	
Employee compensation	1,618,972
Operating supplies	343,226
Incurred losses	7,467,782
Insurance premiums	4,391,154
General and administrative	618,798
Repair and maintenance	81,950
Professional services	682,084
Depreciation	<u>14,847</u>
Total operating expenses	<u>15,218,813</u>
Operating income	<u>705,263</u>
Nonoperating revenues:	
Investment income	<u>503,540</u>
Total nonoperating revenues	<u>503,540</u>
Income before transfers	1,208,803
Transfers in	196,337
Transfers out	<u>(171,446)</u>
Increase in net assets	1,233,694
Net assets, July 1, 2003	<u>13,410,983</u>
Net assets, June 30, 2004	<u>\$14,644,677</u>

See accompanying notes to financial statements.

Pima County
 Self-Insurance Trust Internal Service Fund
 Statement of Cash Flows
 Year Ended June 30, 2004

Cash flows from operating activities:	
Receipts from other funds for goods and services provided	\$15,322,748
Other receipts	507,144
Payments to suppliers for goods and services	(5,107,730)
Payments to other funds for goods and services	(660,634)
Payments to employees	(1,685,223)
Payments for incurred losses	<u>(7,726,235)</u>
Net cash provided by operating activities	<u>650,070</u>
Cash flows from noncapital financing activities:	
Cash transfers from other Pima County funds	196,337
Cash transfers to other Pima County funds	(58,605)
Loans to other Pima County funds	(16,196)
Loans from other Pima County funds	<u>29,723</u>
Net cash provided by noncapital financing activities	<u>151,259</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	<u>(65,363)</u>
Net cash used for capital and related financing activities	<u>(65,363)</u>
Cash flows from investing activities:	
Interest received on investments	<u>521,911</u>
Net cash provided by investing activities	<u>521,911</u>
Net increase in cash and cash equivalents	1,257,877
Cash and cash equivalents, July 1, 2003	<u>38,128,610</u>
Cash and cash equivalents, June 30, 2004	<u>\$39,386,487</u>

(Continued)

See accompanying notes to financial statements.

Pima County
 Self-Insurance Trust Internal Service Fund
 Statement of Cash Flows
 Year Ended June 30, 2004
 (Continued)

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

Operating income	\$ 705,263
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	14,847
Changes in assets and liabilities:	
Increase in:	
Accounts receivable	(152,789)
Prepaid expenses	(4,258)
Accounts payable	466,267
Incurred but not reported losses	1,926,000
Decrease in:	
Due from other governments	58,605
Accrued employee compensation	(66,251)
Interfund payable	(113,161)
Reported but unpaid losses	<u>(2,184,453)</u>
	<u>(55,193)</u>
 Net cash provided by operating activities	 <u>\$ 650,070</u>

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2004, the Fund transferred \$112,841 of capital assets to the County's general capital assets.

During the year ended June 30, 2004, the Fund retired fully depreciated assets with an original cost of \$33,644.

See accompanying notes to financial statements.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2004

Note 1 - Summary of Significant Accounting Policies

The financial statements of the Pima County Self-Insurance Trust Internal Service Fund (Fund) conform to U.S. generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB).

A. Reporting Entity

The Fund is under the direction of an administrator appointed by the Board of Supervisors of Pima County, Arizona (Board). In addition, the Fund is administered by seven Board-appointed joint trustees only one of whom may be a board member and only one of whom may be a county employee. However, the ultimate financial accountability for the Fund remains with the County. The County is responsible for managing and operating 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; medical malpractice; environmental claims; unemployment; natural disasters; and for self-insured dental benefits to eligible employees and their dependents. Fund activities, when incorporated in the County's government-wide financial statements, are reported as portions of the County's governmental activities and business-type activities.

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. A 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 Fund's financial transactions are recorded and reported as an internal service fund because its 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 risk management services to county departments on a continuing basis be financed or recovered primarily through user charges.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2004

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 Fund's financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the cash flows take place. When both restricted and unrestricted net assets are available to finance fund expenses, restricted resources are used before unrestricted resources. Interfund transactions that would be treated as revenues or expenses if they involved parties external to Pima County are recorded in the appropriate revenue or expense accounts.

The Fund follows those FASB Statements and Interpretations, issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements. The Fund has chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

D. Basis of Presentation

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

A statement of net assets provides information about the assets, liabilities, and net assets of the Fund 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 Fund's obligations. Invested in capital assets represents the value of capital assets, net of accumulated depreciation. 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 Fund's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and transfers. Operating revenues and expenses generally result from providing risk management services. Accordingly, revenues such as charges for services are considered to be operating revenues. Other revenues, such as investment income are not generated from operations and are considered to be nonoperating revenues. Operating expenses include the cost of providing services, administrative expenses, and depreciation on capital assets. The Fund did not incur any expenses considered to be nonoperating.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2004

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 either operating, noncapital financing, capital financing, or investing.

E. Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, deposits with the Pima County Treasurer, and deposits with the State Treasurer.

F. Capital Assets

Capital assets are reported at actual cost. The Fund capitalizes all land regardless of cost and all equipment costing at least \$5,000. Depreciation on equipment is calculated over the assets' estimated useful lives of 4 to 20 years with no salvage value, and is charged as an expense against operations using the straight-line method.

G. Liability for Unpaid Claims

The Fund provides for claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The ultimate cost of claims includes incremental claim adjustment expenses that have been allocated to specific claims, as well as salvage and subrogation. No other claim adjustment expenses have been included. The length of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts recoverable from excess insurers, if any, are deducted from the liability for unpaid claims or shown as an asset for paid claims. Because actual claims costs are dependent upon such complex factors as inflation, changes in doctrines of legal liability, exposures, and damage awards, the process used in computing claims liabilities cannot yield an exact result, particularly for liability coverages.

Claims liabilities are recomputed annually and, except for those related to environmental and dental claims, are estimates determined by an independent actuary using the following actuarial methods: incurred loss development, paid loss development, Bornhuetter-Ferguson method, frequency/severity and loss rate. A provision for inflation in the calculation of estimated future claims 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. Environmental claims liabilities are estimates based on reported claims and the county risk manager's knowledge and experience. Dental claims liabilities are based on claims that have been submitted but not yet paid by the Fund. Given the complexity of the 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.

Pima County
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2004

Note 2 - Cash and Cash Equivalents

Cash and cash equivalents consist of \$100 of cash on hand; \$10,508,062 of deposits with the County Treasurer; and \$28,878,325 of deposits with the State Treasurer.

Deposits with the County Treasurer are available on demand and are pooled with other county monies for investment. The Fund's deposits are included in the Treasurer's investment pool but are not identified with specific investments and, therefore, 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.

Deposits with the State Treasurer are invested in the State Treasurer's Local Government Investment Pool and are available on demand. The State Board of Investment provides oversight for the State Treasurer's pools, and the Local Government Investment Pool Advisory Committee provides consultation and advice to the Treasurer. The fair value of a participant's position in the pool approximates the value of that participant's pool shares. Those shares are not identified with specific investments and are not subject to custodial credit risk.

Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2004, was as follows:

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
Capital assets not being depreciated:				
Land	<u>\$ 592,353</u>			<u>\$592,353</u>
Total capital assets not being depreciated	<u>592,353</u>			<u>592,353</u>
Capital assets being depreciated:				
Equipment	174,964	\$ 65,363	\$146,485	93,842
Less accumulated depreciation	<u>100,728</u>	<u>14,847</u>	<u>33,644</u>	<u>81,931</u>
Total capital assets being depreciated, net	<u>74,236</u>	<u>50,516</u>	<u>112,841</u>	<u>11,911</u>
Total capital assets, net	<u>\$ 666,589</u>	<u>\$ 50,516</u>	<u>\$112,841</u>	<u>\$604,264</u>

Note 4 - Risk Management

The Fund is liable for any single general or automobile liability claim up to \$2,000,000 per occurrence, any workers' compensation claim up to \$750,000 per occurrence, and any single medical malpractice claim up to \$1,000,000 per occurrence or any medical malpractice claims in aggregate up to \$5,000,000 in any policy year. The County purchases commercial insurance for claims in excess of coverage provided by the Fund. Settled claims have not exceeded insurance coverage in any of the last 3 fiscal years.

Pima County
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2004

Payment of unemployment, and dental claims is fully self-funded. Payment of environmental claims is generally self-funded, although some claims filed could result in past insurers being liable for such losses.

All of the County's departments participate in the Fund. With the exception of environmental, dental, and unemployment losses, charges are based on actuarial estimates of the amounts needed to pay prior- and current-year claims and to establish some reserve for catastrophic losses. That reserve was estimated to be \$500,000 at June 30, 2004, and is an internal designation of the Fund's net assets. Charges for environmental losses are based on historical experience. Charges for dental and unemployment losses are based on claims that have been submitted, but not yet paid by the Fund.

Claims liabilities at June 30, 2004, for each insurable area follow:

	Reported But Unpaid Losses	Incurred But Not Reported Losses	Total
General liability	\$ 4,149,000	\$ 6,237,000	\$10,386,000
Automobile liability	109,000	397,000	506,000
Medical malpractice	601,000	412,000	1,013,000
Workers' compensation	5,849,000	6,807,000	12,656,000
Dental	71,547		71,547
Environmental	<u>63,000</u>	<u>1,000,000</u>	<u>1,063,000</u>
 Total	 <u>\$10,842,547</u>	 <u>\$14,853,000</u>	 <u>\$25,695,547</u>

The above amounts, excluding environmental and dental, are reported at their present value using an expected future investment yield assumption of 4 percent. Unemployment liabilities have been accrued and reported as accounts payable liabilities.

Changes in the Fund's claims liability amount for the years ended June 30, 2004 and 2003, were as follows:

	2004	2003
Claims liability balance—beginning	\$25,954,000	\$28,112,000
Current-year claims and changes in estimates	7,467,782	7,036,319
Claim payments	<u>(7,726,235)</u>	<u>(9,194,319)</u>
Claims liability balance—ending	<u>\$25,695,547</u>	<u>\$25,954,000</u>

Pima County
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2004

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Due within 1 year
Reported but unpaid losses	\$13,027,000	\$5,541,782	\$7,726,235	\$10,842,547	\$2,441,167
Incurred but not reported	<u>12,927,000</u>	<u>1,926,000</u>	<u> </u>	<u>14,853,000</u>	<u>3,267,660</u>
Total	<u>\$25,954,000</u>	<u>\$7,467,782</u>	<u>\$7,726,235</u>	<u>\$25,695,547</u>	<u>\$5,708,827</u>

Note 5 - Retirement Plan

Plan Description—The Fund contributes to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The System is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes 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 Arizona State Retirement System, 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 Fund's contribution rates. For the year ended June 30, 2004, active plan members and the Fund were each required by statute to contribute at the actuarially determined rate of 5.70 percent (5.20 percent retirement and 0.50 percent long-term disability) of the members' annual covered payroll. The Fund's contributions to the System for the years ended June 30, 2004, 2003, and 2002, were \$51,146, \$24,419, and \$20,754, respectively, which were equal to the required contributions for the year.

Note 6 - Annuity Contracts

In prior fiscal years, the Fund purchased several annuities in claimants' names to fund future payments to these claimants. The Fund believes there is no material contingent liability related to these annuities. Accordingly, the amount of \$1,500,000 has not been reported as an asset or as a liability on the Statement of Net Assets as of June 30, 2004.