



PIMA COUNTY, ARIZONA

Pima County Self-Insurance Trust Internal Service Fund

**For the Fiscal Year Ended
June 30, 2005**

Pima County
Self-Insurance Trust Internal Service Fund
Report on Audit of Financial Statements
Year Ended June 30, 2005

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Independent Auditors' Report

The Board of Supervisors of Pima County, Arizona
Tucson, Arizona

We have audited the accompanying financial statements of Pima County Self Insurance Trust Internal Service Fund as of June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of 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 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 of material misstatement. An audit also 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 the 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 the Pima County Self Insurance Trust Internal Service Fund and do not purport to, and do not, present fairly the financial position of the Pima County, Arizona, as of June 30, 2005, the changes in its financial position, or, where applicable, 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 Pima County Self Insurance Trust Internal Service Fund as of June 30, 2005, and changes in financial position and its cash flows for the year ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2005 on our consideration of Pima County Self Insurance Trust Internal Service 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. Accordingly, we express no such opinion. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Pima County Self Insurance Trust Internal Service Fund previously adopted the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* which requires that Management's Discussion and Analysis be presented as required supplementary information to the financial statements. Pima County Self Insurance Trust Internal Service Fund has not presented Management's Discussion and Analysis that U.S. generally accepted accounting principles has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Bauch, Fleischman + Co., P.C.

September 27, 2005

Pima County
 Self-Insurance Trust Internal Service Fund
 Statement of Net Assets
 June 30, 2005

Assets

Current assets:

Cash and cash equivalents	\$36,278,631
Interest receivable	140,107
Due from other funds	12,003
Accounts receivable	519,463
Prepaid expenses	<u>843,594</u>
Total current assets	<u>37,793,798</u>

Noncurrent assets:

Investments	910,854
Capital assets:	
Land	592,353
Equipment	93,842
Less accumulated depreciation	<u>87,230</u>
Total capital assets, net	<u>598,965</u>
Total noncurrent assets	<u>1,509,819</u>

Total assets	<u>39,303,617</u>
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Liabilities

Current liabilities:

Accounts payable	196,636
Accrued employee compensation	178,594
Due to other funds	58,776
Reported but unpaid losses, current portion	4,068,242
Incurred but not reported losses, current portion	<u>1,791,700</u>
Total current liabilities	<u>6,293,948</u>

Noncurrent liabilities:

Reported but unpaid losses	16,774,290
Incurred but not reported losses	<u>7,638,300</u>
Total noncurrent liabilities	<u>24,412,590</u>

Total liabilities	<u>30,706,538</u>
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Net Assets

Invested in capital assets	598,965
Restricted for investments	9,042,032
Unrestricted	<u>(1,043,918)</u>
Total net assets	<u>\$ 8,597,079</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, 2005

Operating revenues:	
Charges for services	\$13,565,476
Other	<u>735,556</u>
Total operating revenues	<u>14,301,032</u>
Operating expenses:	
Employee compensation	1,852,188
Operating supplies	159,785
Utilities	29,794
Incurred losses	12,925,211
Insurance premiums	4,499,837
General and administrative	741,484
Repairs and maintenance	48,929
Professional services	459,655
Depreciation	<u>5,299</u>
Total operating expenses	<u>20,722,182</u>
Operating loss	<u>(6,421,150)</u>
Nonoperating revenues:	
Investment income	<u>799,601</u>
Total nonoperating revenues	<u>799,601</u>
Loss before transfers	(5,621,549)
Transfers out	<u>(426,049)</u>
Decrease in net assets	(6,047,598)
Net assets, July 1, 2004	<u>14,644,677</u>
Net assets, June 30, 2005	<u>\$ 8,597,079</u>

See accompanying notes to financial statements.

Pima County
Self-Insurance Trust Internal Service Fund
Statement of Net Assets
June 30, 2005

Cash flows from operating activities:	
Receipts from other funds for goods and services provided	\$13,565,476
Other receipts	368,882
Payments to suppliers for goods and services	(5,725,440)
Payments to other funds for goods and services	(621,619)
Payments to employees	(1,793,583)
Payments for incurred losses	<u>(8,348,226)</u>
Net cash used for operating activities	<u>(2,554,510)</u>
Cash flows from noncapital financing activities:	
Cash transfers to other Pima County funds	(191,049)
Loans to other Pima County funds	4,193
Loans from other Pima County funds	<u>29,053</u>
Net cash used for noncapital financing activities	<u>(157,803)</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	<u>(235,000)</u>
Net cash used for capital and related financing activities	<u>(235,000)</u>
Cash flows from investing activities:	
Interest received on investments	750,311
Purchase of investments	<u>(910,854)</u>
Net cash used for investing activities	<u>(160,543)</u>
Net decrease in cash and cash equivalents	(3,107,856)
Cash and cash equivalents, July 1, 2004	<u>39,386,487</u>
Cash and cash equivalents, June 30, 2005	<u>\$36,278,631</u>

(Continued)

See accompanying notes to financial statements.

Pima County
 Self-Insurance Trust Internal Service Fund
 Statement of Cash Flows
 Year Ended June 30, 2005
 (Continued)

Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (6,421,150)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation	5,299
Changes in assets and liabilities:	
Increase in:	
Accounts receivable	(366,674)
Accrued employee compensation	58,605
Reported but unpaid losses	9,999,985
Decrease in:	
Prepaid expenses	70,799
Accounts payable	(478,374)
Incurred but not reported losses	<u>(5,423,000)</u>
	<u>3,866,640</u>
Net cash used for operating activities	<u>\$ (2,554,510)</u>

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2005, the Fund transferred \$235,000 of capital assets to the County's general capital assets.

See accompanying notes to financial statements.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2005

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 summary of the Fund's more significant accounting policies follows.

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 a proprietary 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, 2005

Note 1 - Summary of Significant Accounting Policies (continued)

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 recognized 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 the 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 restrictions or availability of assets to satisfy the Fund's obligations. Invested in capital assets represents the cost 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, 2005

Note 1 - Summary of Significant Accounting Policies (continued)

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 Investments

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. The investments are reported at estimated fair value.

F. Receivables

Insurance claims recoveries unpaid at the end of the fiscal year are reported as accounts receivable. In addition, unpaid employment and dental premiums due from other County funds are also reported as accounts receivable.

G. 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.

H. 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, unemployment 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.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2005

Note 1 - Summary of Significant Accounting Policies (continued)

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. Unemployment and 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.

Note 2 - Cash and Investments

Cash and cash equivalents consist of \$100 of cash on hand; \$6,711,611 of deposits with the County Treasurer; and \$29,566,920 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 or shares and, therefore, are not subject to custodial credit risk.

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 State 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.

The Fund's nonpooled investment of \$910,854 is invested in one of the County's improvement districts. The investment is unregistered and guaranteed by the taxing authority of the County.

Interest Rate Risk- Interest rate risk is the risk that changes in interest rates will adversely affect an investment's fair value. 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. The County does not have a formal investment policy with respect to interest rate risk. The County Treasurer's investment pool had a weighted average maturity of 80 days.

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. Both the County Treasurer's and the State Treasurer's investment pools are unrated.

Pima County
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2005

Note 2 - Cash and Investments (continued)

Concentration of Credit Risk - Statutes do not include any requirements for concentration of credit risk.

Foreign Currency Risk - Statutes do not allow foreign investments.

Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2005, was as follows:

	Balance July 1, 2004	Increases	Decreases	Balance June 30, 2005
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	93,842	\$ 235,000	\$ 235,000	93,842
Less accumulated depreciation	<u>81,931</u>	<u>5,299</u>	<u> </u>	<u>87,230</u>
Total capital assets being				
depreciated, net	<u>11,911</u>	<u>229,701</u>	<u>235,000</u>	<u>6,612</u>
Total capital assets, net	<u>\$ 604,264</u>	<u>\$ 229,701</u>	<u>\$ 235,000</u>	<u>\$ 598,965</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.

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, 2005, 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.

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2005

Note 4 - Risk Management (continued)

Claims liabilities at June 30, 2005, for each insurable area follow:

	Reported But Unpaid Losses	Incurred But Not Reported Losses	Total
General liability	\$10,686,000	\$3,479,000	\$14,165,000
Automobile liability	899,000	362,000	1,261,000
Medical malpractice	687,000	237,000	924,000
Workers' compensation	8,374,000	4,352,000	12,726,000
Dental	53,106		53,106
Unemployment	80,426		80,426
Environmental	<u>63,000</u>	<u>1,000,000</u>	<u>1,063,000</u>
Total	<u>\$20,842,532</u>	<u>\$9,430,000</u>	<u>\$30,272,532</u>

The above amounts, excluding environmental, unemployment and dental, are reported at their present value using an expected future investment yield assumption of 4 percent.

Changes in the Fund's claims liability amount for the years ended June 30, 2005 and 2004, were as follows:

	2005	2004
Claims liability balance—beginning	\$25,695,547	\$25,954,000
Current-year claims and changes in estimates	12,925,211	7,467,782
Claim payments	<u>(8,348,226)</u>	<u>(7,726,235)</u>
Claims liability balance—ending	<u>\$30,272,532</u>	<u>\$25,695,547</u>

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Due within 1 year
Reported but unpaid losses	\$10,842,547	\$12,925,211	\$2,925,226	\$20,842,532	\$4,068,242
Incurred but not reported	<u>14,853,000</u>	<u> </u>	<u>5,423,000</u>	<u>9,430,000</u>	<u>1,791,700</u>
Total	<u>\$25,695,547</u>	<u>\$12,925,211</u>	<u>\$8,348,226</u>	<u>\$30,272,532</u>	<u>\$5,859,942</u>

Pima County
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2005

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 at 3300 North Central Avenue, P.O. Box 33910, Phoenix, AZ 85067-3910, or by calling (602) 240-2000 or on-line, at <http://www.asrs.state.az.us/web/Aboutus.do>

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, 2005, 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, 2005, 2004, and 2003, were \$62,080, \$51,146, and \$24,419, 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 \$1,300,000 has not been reported as an asset or as a liability on the Statement of Net Assets as of June 30, 2005.

Note 7 - Restricted Net Assets

The Fund has restricted net assets in the amount of \$9,042,032. This amount has been posted as security with the State Treasurer for future Worker's Compensation claims as part of an agreement with the Industrial Commission of Arizona.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL
CONTROLS OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Members of the Arizona State Legislature
The Board of Supervisors of Pima County, Arizona

We have audited the financial statements of Pima County Self Insurance Trust Internal Service Fund as of and for the year ended June 30, 2005, and have issued our report thereon dated September 27, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pima County Self Insurance Trust Internal Service Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pima County Self Insurance Trust Internal Service Fund's financial statements are free of 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*.

This report is intended solely for the information and use of the management, members of the Arizona State Legislature and the Board of Supervisors of Pima County Arizona and is not intended to be and should not be used by anyone other than these specified parties.

Beach, Fleischman & Co., P.C.

September 27, 2005

