



2006

Pima County
Self-Insurance Trust
Internal Service Fund

PIMA COUNTY ARIZONA

For the Fiscal Year Ended June 30, 2006

Pima County
Self Insurance Trust Internal Service Fund
Report on Audit of Financial Statements
June 30, 2006

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Independent Auditors' Report

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

We have audited the accompanying basic financial statements of Pima County Self Insurance Trust Internal Service Fund as of June 30, 2006, 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 established by the AICPA Auditing Standards Board 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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, 2006, or 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, 2006, and changes in its 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 26, 2006 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 the State and Local Governments which requires that Management's Discussion and Analysis be presented 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.

September 26, 2006

Beach, Fleischman & Co., P.C.

Pima County
Self Insurance Trust Internal Service Fund
Statement of Net Assets
June 30, 2006

Assets

Current assets:

Cash and cash equivalents	\$ 38,298,412
Interest receivable	131,945
Accounts receivable	234,967
Prepaid expenses	784,466
Total current assets	39,449,790

Noncurrent assets:

Investments	910,854
Capital assets:	
Land	592,353
Equipment	94,775
Less accumulated depreciation	59,439
Total capital assets, net	627,689
Total noncurrent assets	1,538,543

Total assets	40,988,333
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Liabilities

Current liabilities:

Accounts payable	238,741
Accrued employee compensation	100,442
Due to other governments	106
Reported but unpaid losses, current portion	5,506,628
Incurred but not reported, current portion	2,046,240
Total current liabilities	7,892,157

Noncurrent liabilities:

Reported but unpaid losses	20,257,180
Incurred but not reported losses	7,697,760
Total noncurrent liabilities	27,954,940

Total liabilities	35,847,097
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Net assets

Invested in capital assets	627,689
Unrestricted	4,513,547
	5,141,236

Total net assets	\$ 5,141,236
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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, 2006

Operating revenues:	
Charges for services	\$ 14,527,448
Other	<u>699,976</u>
Total operating revenues	<u>15,227,424</u>
Operating expenses:	
Employee compensation	2,041,468
Operating supplies	325,895
Utilities	25,898
Incurred losses	12,185,222
Insurance premiums	4,271,827
General and administrative	667,173
Repairs and maintenance	46,051
Professional services	497,424
Depreciation	<u>1,843</u>
Total operating expenses	<u>20,062,801</u>
Operating loss	<u>(4,835,377)</u>
Nonoperating revenues :	
Investment income	1,380,047
Loss on disposal of capital assets	<u>(513)</u>
Total nonoperating revenues	<u>1,379,534</u>
Decrease in net assets	(3,455,843)
Net assets, July 1, 2005	<u>8,597,079</u>
Net assets, June 30, 2006	<u><u>\$ 5,141,236</u></u>

See accompanying notes to financial statements

Pima County
Self Insurance Trust Internal Service Fund
Statement of Cash Flows
Year Ended June 30, 2006

Cash flows from operating activities:

Receipts from other funds for goods and services provided	\$ 14,527,448
Other receipts	984,472
Payments to suppliers for goods and services	(4,467,620)
Payments to other funds for goods and services	(1,265,309)
Payments to employees	(2,119,620)
Payments for incurred losses	(6,949,946)
Net cash provided by operating activities	709,425

Cash flows from noncapital financing activities:

Loans from other Pima County Funds	(46,773)
Net cash used for noncapital financing activities	(46,773)

Cash flows from capital and related financing activities:

Purchases of capital assets	(31,080)
Net cash used for capital and related financing activities	(31,080)

Cash flows from investing activities:

Interest received on investments	1,388,209
Net cash provided by investing activities	1,388,209
Net increase in cash and cash equivalents	2,019,781
Cash and cash equivalents, July 1, 2005	36,278,631
Cash and cash equivalents, June 30, 2006	\$ 38,298,412

See accompanying notes to financial statements

Pima County
 Self Insurance Trust Internal Service Fund
 Statement of Cash Flows
 Year Ended June 30, 2006
 (Continued)

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

Operating loss	\$ (4,835,377)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	1,843
Changes in assets and liabilities:	
Increase in:	
Accounts payable	42,105
Due to other governments	106
Incurred but not reported losses	314,000
Reported but unpaid losses	4,921,276
Decrease in:	
Prepaid expenses	59,128
Accounts receivable	284,496
Employee compensation payable	(78,152)
	(78,152)
Net cash provided by operating activities	\$ 709,425

Noncash investing, capital, and noncapital financing activities:

During the year ended June 30, 2006, the Fund retired capital assets with a net book value of \$513.

See accompanying notes to financial statements

Pima County
Self Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2006

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.

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.

Pima County
Self Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2006

Note 1 - Summary of Significant Accounting Policies (continued)

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.

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 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.

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.

Pima County
Self Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2006

Note 1 - Summary of Significant Accounting Policies (continued)

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, Berquist-Sherman, frequency and 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. 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; \$7,359,966 of deposits with the County Treasurer; and \$30,938,346 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. The investment represents the debt of the La Cholla Improvement District. Contractually, the debt cannot be sold on the secondary market. Therefore, Management has determined that no difference exists between face value and fair market value.

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 22 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.

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

Foreign Currency Risk – Statutes do not allow foreign investments.

Pima County
Self Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2006

Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2006, was as follows:

	<u>Balance July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2006</u>
Capital assets not being depreciated:				
Land	\$ 592,353			\$ 592,353
Total capital assets not being depreciated	<u>592,353</u>			<u>592,353</u>
Capital assets being depreciated:				
Equipment	93,842	\$ 31,080	\$ 30,147	94,775
Less accumulated depreciation	<u>87,230</u>	<u>1,843</u>	<u>29,634</u>	<u>59,439</u>
Total capital assets being depreciated, net	<u>6,612</u>	<u>29,237</u>	<u>513</u>	<u>35,336</u>
Total capital assets, net	<u>\$ 598,965</u>	<u>\$ 29,237</u>	<u>\$ 513</u>	<u>\$ 627,689</u>

Note 4 – Claims, Judgments and 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. Charges for environmental losses are based on historical experience. Charges for dental and unemployment losses are based on actual claims paid.

Claims liabilities at June 30, 2006, for each insurable area follow:

	<u>Reported But Unpaid Losses</u>	<u>Incurred But Not Reported Losses</u>	<u>Total</u>
General liability	\$12,802,000	\$3,637,000	\$16,439,000
Automobile liability	948,000	391,000	1,339,000
Medical malpractice	1,082,000	264,000	1,346,000
Workers' compensation	10,810,000	4,452,000	15,262,000
Dental	68,045		68,045
Unemployment	53,763		53,763
Environmental	<u> </u>	<u>1,000,000</u>	<u>1,000,000</u>
Total	<u>\$25,763,808</u>	<u>\$9,744,000</u>	<u>\$35,507,808</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.

Pima County
Self Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2006

Note 4 – Claims, Judgments and Risk Management (continued)

Changes in the Fund’s claims liability amount for the years ended June 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Claims liability balance—beginning	\$30,272,532	\$25,695,547
Current-year claims and changes in estimates	12,185,222	12,925,211
Claim payments	<u>(6,949,946)</u>	<u>(8,348,226)</u>
Claims liability balance—ending	<u>\$35,507,808</u>	<u>\$30,272,532</u>

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Due within</u> <u>1 year</u>
Reported but unpaid losses	\$20,842,532	\$11,871,222	\$6,949,946	\$25,763,808	\$5,506,628
Incurred but not reported	<u>9,430,000</u>	<u>314,000</u>	<u> </u>	<u>9,744,000</u>	<u>2,046,240</u>
Total	<u>\$30,272,532</u>	<u>\$12,185,222</u>	<u>\$6,949,946</u>	<u>\$35,507,808</u>	<u>\$7,552,868</u>

Note 5 - 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 \$1,030,000 has not been reported as an asset or as a liability on the Statement of Net Assets as of June 30, 2006.

Note 6 - Retirement Plan

Plan Description—The Fund contributes to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the ASRS 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, 2006, active plan members and the Fund were each required by statute to contribute at the actuarially determined rate of 7.40 percent (6.90 percent retirement and 0.50 percent long-term disability) of the members’ annual covered payroll. The Fund’s contributions to the ASRS for the years ended June 30, 2006, 2005, and 2004, were \$80,804, \$62,080, and \$51,146, respectively, which were equal to the required contributions for the year.



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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL
CONTROL 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, 2006, and have issued our report thereon dated September 26, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards established by the AICPA Auditing Standards Board 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.

September 26, 2006

Beach, Fleischman & Co., P.C.