**PIMA COUNTY, ARIZONA**
Self Insurance Trust Internal Service Fund
June 30, 2010

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<td></td>
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</tbody>
</table>
Independent Auditors’ Report

To the Honorable 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, a proprietary fund of Pima County, Arizona as of June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of Pima County, Arizona’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 established by the AICPA 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Pima County Self Insurance Trust Internal Service Fund and do not purport to, and do not, present fairly the financial position of Pima County, Arizona as of June 30, 2010, 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, 2010, and the changes in financial position and cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated November 23, 2010 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.

U.S. generally accepted accounting principles requires that management’s discussion and analysis be presented as supplementary information to the financial statements. Pima County Self Insurance Trust Internal Service Fund has not presented the management’s discussion and analysis that U.S. generally accepted accounting principles has determined is necessary to supplement the financial statements.

Walker & Armstrong LLP

November 23, 2010
Phoenix, Arizona
PIMA COUNTY, ARIZONA  
Self Insurance Trust Internal Service Fund  
Statement of Net Assets  
June 30, 2010

**Assets**

Current assets:
- Cash and cash equivalents $50,326,821
- Interest receivable $59,343
- Due from other Pima County funds $156,792
- Accounts receivable $14,874
- Prepaid expenses $563,271

  Total current assets $51,121,101

Noncurrent assets:
- Due from other Pima County funds $131,042

Capital assets:
- Land $592,353
- Equipment $210,005
- Less accumulated depreciation $(135,001)
- Construction in progress $157,834

  Total capital assets, (net) $825,191

  Total noncurrent assets $956,233

Total assets $52,077,334

**Liabilities**

Current liabilities:
- Accounts payable $726,356
- Accrued employee compensation $75,940
- Due to other Pima County funds $79,039
- Reported but unpaid losses, current portion $3,906,282
- Incurred but not reported losses, current portion $2,922,733

  Total current liabilities $7,710,350

Noncurrent liabilities:
- Reported but unpaid losses $17,958,580
- Incurred but not reported losses $13,589,883

  Total noncurrent liabilities $31,548,463

Total liabilities $39,258,813

**Net assets**

- Invested in capital assets $825,191
- Unrestricted $11,993,330

  Total net assets $12,818,521

See accompanying notes to financial statements
# PIMA COUNTY, ARIZONA
Self Insurance Trust Internal Service Fund
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2010

<table>
<thead>
<tr>
<th>Operating revenues:</th>
<th>$19,399,708</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charges for services</td>
<td>$19,343,443</td>
</tr>
<tr>
<td>Other</td>
<td>56,265</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating expenses:</th>
<th>$17,157,015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee compensation</td>
<td>1,675,488</td>
</tr>
<tr>
<td>Operating supplies</td>
<td>181,478</td>
</tr>
<tr>
<td>Utilities</td>
<td>15,151</td>
</tr>
<tr>
<td>Incurred losses</td>
<td>9,893,491</td>
</tr>
<tr>
<td>Insurance premiums</td>
<td>3,587,743</td>
</tr>
<tr>
<td>General and administrative</td>
<td>1,395,028</td>
</tr>
<tr>
<td>Repairs and maintenance</td>
<td>90,601</td>
</tr>
<tr>
<td>Professional services</td>
<td>282,949</td>
</tr>
<tr>
<td>Depreciation</td>
<td>35,086</td>
</tr>
</tbody>
</table>

Operating income: $2,242,693

<table>
<thead>
<tr>
<th>Nonoperating revenues (expenses):</th>
<th>$585,224</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intergovernmental revenue</td>
<td>35,017</td>
</tr>
<tr>
<td>Investment income</td>
<td>550,338</td>
</tr>
<tr>
<td>Loss on disposal of capital assets</td>
<td>(131)</td>
</tr>
</tbody>
</table>

Total nonoperating revenues: $585,224

Income before transfers: $2,827,917

Transfers (out) (58,961)

Change in net assets: $2,768,956

Net assets, July 1, 2009: $10,049,565

Net assets, June 30, 2010: $12,818,521

See accompanying notes to financial statements.
**Cash flows from operating activities:**
- Receipts from other funds for goods and services $19,343,443
- Other receipts 43,961
- Payments to suppliers for goods and services $(3,663,754)
- Payments to other funds for goods and services $(1,921,584)
- Payments to employees $(1,187,165)
- Payments for incurred losses $(8,509,535)
Net cash provided by operating activities 4,105,366

**Cash flows from noncapital financing activities:**
- Cash transfers with Pima County funds $(58,961)
- Loans with other Pima County funds 219,967
- Intergovernmental receipts 35,017
Net cash provided by for noncapital financing activities 196,023

**Cash flows from capital and related financing activities:**
- Purchases of capital assets $(33,545)
Net cash used for capital and related financing activities $(33,545)

**Cash flows from investing activities:**
- Interest received on investments 615,018
Net cash provided by investing activities 615,018

Net increase in cash and cash equivalents 4,882,862

Cash and cash equivalents, July 1, 2009 45,443,959

**Cash and cash equivalents, June 30, 2010** $50,326,821

(continued)
Reconciliation of operating income to net cash provided by operating activities

Operating income $2,242,693

Adjustments to reconcile operating income to net cash provided by operating activities:

Depreciation 35,086

Changes in assets and liabilities:

Decrease (increase) in assets:

Accounts receivable $(12,304)
Prepaid expenses 189,678

Increase (decrease) in liabilities:

Accounts payable 294,610
Employee compensation payable $(28,353)
Reported but unpaid losses (2,669,660)
Incurred but not reported losses 4,053,616

Net cash provided by operating activities $4,105,366

Noncash investing, capital and noncapital financing activities:

During the year ended June 30, 2010, the Self Insurance Trust Internal Service Fund disposed of capital assets with a net book value of $131.
Note 1 - Summary of Significant Accounting Policies

The accounting policies of Pima County (County) and its Self Insurance Trust Internal Service 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.

During the year ended June 30, 2010, Pima County adopted early implementation of the provisions of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, however, GASB Statement No. 54 does not apply to the Fund.

A. Reporting Entity

The Fund is accounted for as an internal service fund of Pima County, Arizona, and the ultimate financial accountability for the Fund remains with Pima County. The Fund’s management is responsible for managing the operation and 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.

The financial statements present only the Self Insurance Trust Internal Service 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, 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. It is the intent of the Board of Supervisors that the costs (expenses, including depreciation) of services provided by the Fund 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 and determines when revenues and expenses 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 flows. 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. Unless in conflict with GASB pronouncements, the Fund follows Financial Accounting Standard Board Statements and Interpretations, issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins. 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. Restricted net assets represent grants, contracts, and other resources that have been externally restricted for specific purposes. 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 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. Generally, charges for services and other fees for Risk Management 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 risk management 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 and related financing, or investing.

E. Cash and Cash Equivalents

Cash and cash equivalents consist of deposits with the Pima County Treasurer, deposits with a fiscal agent for Worker’s Compensation, and deposits with the Arizona State Treasurer.

F. Accounts Receivables

Accounts receivable primarily consist of amount of insurance claims recoveries unpaid at the end of the fiscal year. 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, all equipment costing at least $5,000 and intangible software assets costing at least $100,000. Depreciation on equipment and software 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.
Note 1 - Summary of Significant Accounting Policies (continued)

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 selected loss development factors based on unadjusted data.

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.

I. 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 service, but any vacation hours in excess of the maximum amount that are unused at the year-end are forfeited. Upon termination of employment, all unused and unforfeited vacation benefits are paid to employees. Accordingly, vacation benefits are accrued as a liability in the financial statements.

Employees may accumulate up to 1,920 hours of sick leave. 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 to Arizona State Retirement System, Public Safety Personnel Retirement System, or Corrections Officer Retirement Plan 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 equivalents consist of $15,216,061 of deposits with the County Treasurer; $422,157 of deposits with a fiscal agent for worker’s compensation; and $34,688,603 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.
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.

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 investments had a weighted average maturity of 177 days.

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 the 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.

Foreign Currency Risk – Statutes do not allow foreign investments.
Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2010, was as follows:

<table>
<thead>
<tr>
<th></th>
<th>Balance</th>
<th>Increases</th>
<th>Decreases</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>July 1, 2009</td>
<td></td>
<td></td>
<td>June 30, 2010</td>
</tr>
<tr>
<td>Capital assets not being depreciated:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$ 592,353</td>
<td></td>
<td></td>
<td>$ 592,353</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>124,289</td>
<td>$ 33,545</td>
<td></td>
<td>157,834</td>
</tr>
<tr>
<td>Total capital assets not being depreciated</td>
<td>716,642</td>
<td>33,545</td>
<td></td>
<td>750,187</td>
</tr>
<tr>
<td>Capital assets being depreciated:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>248,392</td>
<td>$ (38,387)</td>
<td></td>
<td>210,005</td>
</tr>
<tr>
<td>Less accumulated depreciation</td>
<td>(138,171)</td>
<td>(35,086)</td>
<td>38,256</td>
<td>(135,001)</td>
</tr>
<tr>
<td>Total capital assets being depreciated, net</td>
<td>110,221</td>
<td>(35,086)</td>
<td>(131)</td>
<td>75,004</td>
</tr>
<tr>
<td>Total capital assets, net</td>
<td>$ 826,863</td>
<td>$ (1,541)</td>
<td>$ (131)</td>
<td>$ 825,191</td>
</tr>
</tbody>
</table>

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

Claims liabilities at June 30, 2010, for each insurable area follow:

<table>
<thead>
<tr>
<th></th>
<th>Reported Incurred But Unpaid Losses</th>
<th>Incurred But Not Reported Losses</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>General liability</td>
<td>$11,285,756</td>
<td>$6,450,126</td>
<td>$17,735,882</td>
</tr>
<tr>
<td>Automobile liability</td>
<td>315,879</td>
<td>436,944</td>
<td>752,823</td>
</tr>
<tr>
<td>Medical malpractice</td>
<td>77,089</td>
<td>212,954</td>
<td>290,043</td>
</tr>
<tr>
<td>Workers’ compensation</td>
<td>10,142,151</td>
<td>8,412,592</td>
<td>18,554,743</td>
</tr>
<tr>
<td>Dental</td>
<td>43,987</td>
<td></td>
<td>43,987</td>
</tr>
<tr>
<td>Environmental</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$21,864,862</td>
<td>$16,512,616</td>
<td>$38,377,478</td>
</tr>
</tbody>
</table>

The above amounts, excluding environmental, unemployment and dental, are reported at their present value using an expected future investment yield assumption of 2 percent for general and automobile liabilities and 4 percent for medical malpractice.

Changes in the Fund’s claims liability amount for the years ended June 30, 2010 and 2009 were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims liabilities - beginning</td>
<td>$36,993,522</td>
<td>$31,205,348</td>
</tr>
<tr>
<td>Current-year claims and changes in estimates</td>
<td>9,893,491</td>
<td>12,599,568</td>
</tr>
<tr>
<td>Claims payment</td>
<td>(8,509,535)</td>
<td>(6,811,394)</td>
</tr>
<tr>
<td><strong>Claims liabilities balance - ending</strong></td>
<td>$38,377,478</td>
<td>$36,993,522</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Balance July 1, 2009</th>
<th>Additions</th>
<th>Reductions</th>
<th>Balance June 30, 2010</th>
<th>Due within 1 year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported but unpaid losses</td>
<td>$24,534,522</td>
<td>$5,839,875</td>
<td>(8,509,535)</td>
<td>$21,864,862</td>
<td>$3,906,282</td>
</tr>
<tr>
<td>Incurred but not reported</td>
<td>12,459,000</td>
<td>4,053,616</td>
<td></td>
<td>16,512,616</td>
<td>2,922,733</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$36,993,522</td>
<td>$9,893,491</td>
<td>(8,509,535)</td>
<td>$38,377,478</td>
<td>$6,829,015</td>
</tr>
</tbody>
</table>

Note 5 – Interfund Receivable from Other Pima County Funds

The Fund purchased Improvement District bonds of $1,821,707 at 6.5% interest rate on February 16, 2002 for La Cholla Boulevard and $122,500 at 8.0% interest rate on September 1, 2006 for Camino Ojo de Agua. The interfund receivable from the two County’s improvement districts is $277,675. This amount represents the receivable of $262,084 from the La Cholla Boulevard Improvement District and $15,591 from the Camino Ojo De Agua Improvement District.
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 $1,264,113 has not been reported as an asset or as a liability on the Statement of Net Assets as of June 30, 2010.

Note 7 - Retirement Plan

Plan Description—The County 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, 2010, active ASRS members were required by statute to contribute at the actuarially determined rate of 9.4 percent (9.0 percent for retirement and 0.4 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 9.4 percent (8.34 percent for retirement, 0.66 percent for health insurance premium, and 0.4 percent for long-term disability) of the members’ annual covered payroll.

The County’s contributions for the current and two preceding years, all of which were equal to the required contributions, were as follows:

<table>
<thead>
<tr>
<th>Years ended June 30</th>
<th>Retirement Fund</th>
<th>Health Benefit</th>
<th>Long-Term Disability Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Supplement Fund</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$77,052</td>
<td>$6,098</td>
<td>$3,696</td>
</tr>
<tr>
<td>2009</td>
<td>79,246</td>
<td>9,521</td>
<td>4,959</td>
</tr>
<tr>
<td>2008</td>
<td>89,570</td>
<td>11,683</td>
<td>5,563</td>
</tr>
</tbody>
</table>
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

To the Honorable Board of Supervisors
of Pima County, Arizona
Tucson, Arizona

We have audited the financial statements of Pima County Self Insurance Trust Internal Service Fund (the “Fund”) a proprietary fund of Pima County, Arizona, as of June 30, 2010 and have issued our report thereon dated November 23, 2010. 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 the Fund’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund’s internal control over financial reporting.

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 a 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, described below; that we consider to be a significant deficiency. 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.

Improve Internal Controls over Claims Processing

The Fund uses third party administrators ("TPAs") for processing workers' compensation and dental claims. As a result, the County places reliance on the TPA’s internal controls over the claims processing cycle. During our testing of this cycle, we performed tests of internal controls applicable to the review, approval and disbursement of claims. This includes obtaining, when available, reports on internal control for audits performed in accordance with Statement on Auditing Standard Number 70, Service Organizations, ("SAS 70") issued by the Auditing Standards Board.
In reviewing the SAS 70 report prepared for the Fund’s workers’ compensation TPA, we noted that the TPA’s independent services auditor reported certain deficiencies related to the lack of segregation of duties over the establishment of claims and the initiation and printing of claims checks. This deficiency resulted in a modification of the independent service auditor’s opinion in which the stated internal control objectives applicable to the TPA’s segregation of duties over the cash disbursement process were not met.

During fiscal year 2010, Fund management was unaware that the workers’ compensation TPA had control deficiencies related to claims processing that were significant to warrant a modified service auditor’s report. Also, Fund management was unaware that the dental claims TPA did not have an audit performed in accordance SAS 70.

In both instances, the Fund’s internal controls over claims processing were not designed or operated in a manner that considered the TPAs’ internal control structure. However, for workers’ compensation claims, the Fund had internal controls in place to review the claims processed by the TPA, which reduces the risk of undetected errors. Such internal controls were not in place for dental claims.

We recommend that Fund’s policies and procedures consider whether the TPA has placed in operation relevant internal controls and their operating effectiveness.

Management’s Response:

The County agrees the Fund’s policies and procedures should include language that requires knowledge of the internal control structure of each third party administrator (TPA). The County believes the internal control structure of the selected TPAs were adequate when initially contracted; however, subsequent reviews are warranted.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 Pima County, Arizona’s management, Board of Supervisors and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

Phoenix, Arizona
November 23, 2010