

2016

Self-Insurance Trust Internal Service Fund



Pima County, Arizona
For the Fiscal Year Ended June 30, 2016

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Year Ended June 30, 2016

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Independent Auditors' Report

To the Honorable Board of Supervisors
of Pima County, Arizona

Report on The Financial Statements

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 and for the year ended June 30, 2016, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pima County Self Insurance Trust Internal Service Fund as of June 30, 2016, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only 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, 2016, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Management has omitted management's discussion and analysis and the 10-year schedule of pension information required for cost-sharing plans that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historic context.. Our opinion on the financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2016, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Pima County Self Insurance Trust Internal Service Fund's internal control over financial reporting and compliance.

Walker & Armstrong, LLP

Phoenix, Arizona
October 25, 2016

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Statement of Net Position
June 30, 2016

Assets

Current assets:	
Cash and cash equivalents	\$ 69,417,428
Interest receivable	8,786
Due from other funds	7,896
Accounts receivable	1,052
Prepaid expense	752,035
Total current assets	<u>70,187,197</u>
Noncurrent assets:	
Loan receivable	6,700,000
Capital assets:	
Land and other improvements	448,562
Equipment	168,271
Less accumulated depreciation	<u>(164,971)</u>
Total capital assets (net of accumulated depreciation)	<u>451,862</u>
Total noncurrent assets	<u>7,151,862</u>
Total assets	<u>\$ 77,339,059</u>

Deferred outflows of resources

Deferred outflows related to pensions	<u>175,903</u>
Total deferred outflows of resources	<u>175,903</u>
Total assets and deferred outflows of resources	<u>\$ 77,514,962</u>

Liabilities

Current liabilities:	
Accounts payable	606,240
Employee compensation	32,846
Due to other funds	5,921
Current portion reported but unpaid losses	5,007,008
Current portion incurred but not reported losses	<u>2,164,881</u>
Total current liabilities	<u>7,816,896</u>
Noncurrent liabilities:	
Compensated absences payable	52,738
Reported but unpaid losses	22,656,020
Incurred but not reported losses	11,295,789
Net pension liability	<u>1,831,821</u>
Total noncurrent liabilities	<u>35,836,368</u>
Total liabilities	<u>43,653,264</u>

Deferred inflows of resources

Deferred inflows related to pensions	<u>180,800</u>
Total deferred inflows of resources	<u>180,800</u>
Total liabilities and deferred inflows of resources	<u>\$ 43,834,064</u>

Net position

Net investment in capital assets	451,862
Unrestricted	<u>33,229,036</u>
Total net position	<u>\$ 33,680,898</u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Statement of Revenues, Expenses and Changes in Fund Net Position
Year Ended June 30, 2016

Operating revenues:	
Charges for services	\$ 17,420,782
Other	<u>25,393</u>
Total operating revenues	<u>17,446,175</u>
Operating expenses:	
Employee compensation	2,108,863
Operating supplies and services	230,716
Utilities	23,598
Incurred losses	4,606,325
Claim losses - change in actuarial estimates	13,946,844
Insurance premiums	3,825,613
General and administrative	1,017,556
Repair and maintenance	406,882
Consultants and professional services	610,031
Depreciation	<u>1,942</u>
Total operating expenses	<u>26,778,370</u>
Operating loss	<u>(9,332,195)</u>
Nonoperating revenues:	
Investment earnings	972,245
Loss on disposal of capital assets	<u>(13,000)</u>
Total nonoperating revenues	<u>959,245</u>
Loss before transfers	(8,372,950)
Transfers in	9,000
Transfers (out)	<u>(189,754)</u>
Change in net position	(8,553,704)
Net position, July 1, 2015	<u>42,234,602</u>
Net position, June 30, 2016	<u><u>\$ 33,680,898</u></u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Statement of Cash Flows
Year Ended June 30, 2016

Cash flow from operating activities:	
Cash received from other funds for goods and services provided	\$ 17,655,185
Cash received from miscellaneous operations	25,393
Cash payments to suppliers for goods and services	(4,912,490)
Cash payments to other funds for goods and services	(1,155,870)
Cash payments for incurred losses	(4,606,325)
Cash payments to employees for services	<u>(2,186,901)</u>
Net cash provided by operating activities	<u>4,818,992</u>
Cash flows from noncapital financing activities:	
Cash transfers in from other funds	9,000
Cash transfers out to other funds	(189,754)
Loans with other funds	<u>3,300,000</u>
Net cash provided by noncapital financing activities	<u>3,119,246</u>
Cash flows from capital and related financing activities:	
Purchase of capital asset	<u>(13,198)</u>
Net cash used for capital and related financing activities	<u>(13,198)</u>
Cash flows from investing activities:	
Interest on cash and investments	<u>961,378</u>
Net cash provided by investing activities	<u>961,378</u>
Net increase in cash and cash equivalents	8,886,418
Cash and cash equivalents at beginning of year	60,531,010
Cash and cash equivalents, June 30, 2016	<u><u>\$ 69,417,428</u></u>

(continued)

PIMA COUNTY, ARIZONA
 Self-Insurance Trust Internal Service Fund
 Statement of Cash Flows
 Year Ended June 30, 2016

(continued)

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

Operating loss	\$ (9,332,196)
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	1,942
Changes in assets and deferred outflows of resources:	
Decrease (increase) in assets:	
Accounts receivable	234,403
Prepaid expenses	(32,900)
Decrease in deferred outflows of resources:	
Pension plan	50,075
Changes in liabilities and deferred inflows of resources:	
Increase (decrease) in liabilities:	
Accounts payable	78,937
Reported but unpaid losses	11,805,196
Incurred but not reported losses	2,141,648
Net pension liability	58,109
Other liabilities	(56,855)
Decrease in deferred inflows of resources:	
Pension plan	(129,367)
Net cash provided by operating activities	<u>\$ 4,818,992</u>

Self-Insurance Trust Fund transferred out an asset with a net book value of \$13,000.

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

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.

For the year ended June 30, 2016, the County implemented the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*; GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain provisions of GASB Statements 67 and 68*; and GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. GASB Statement No. 72 establishes standards for measuring fair value and applying fair value to certain investments and disclosures related to all fair value measurements. GASB Statement No. 73 amended GASB Statement No. 68 requirements related to note disclosures for pension related required supplementary information and payables to defined benefit pension plans. GASB Statement No. 76 establishes the hierarchy of sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with generally accepted accounting principles. The County also early implemented the provisions of GASB Statement No. 82, *Pension Issues*. GASB Statement No. 82 amends certain provisions of GASB Statements No. 67, No. 68 and No. 73.

A summary of the County's significant accounting policies affecting the Fund follows.

A. Reporting Entity

The Fund is accounted for as an internal service fund of Pima County, Arizona, that is governed by a separately elected board of supervisors, 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; and natural disasters.

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, deferred outflows of resources, liabilities, deferred inflows of resources, net position, 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.

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 1 - Summary of Significant Accounting Policies (continued)

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 position are available to finance Fund expenses, restricted resources are used before unrestricted components of 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.

D. Basis of Presentation

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

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

A statement of revenues, expenses, and changes in net position provides information about the Fund's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net position are reported, including capital contributions and transfers. Generally, charges for services and other 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

For the statement of cash flows, the County's cash and cash equivalents are considered to be cash on hand, demand deposits, cash and investments held by the County Treasurer, investments in the State Treasurer's Local Government Investment Pool (LGIP), and only those highly liquid investments with a maturity of 3 months or less when purchased.

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 1 - Summary of Significant Accounting Policies (continued)

E. Cash and Cash Equivalents (continued)

Cash and cash equivalents consist of deposits with the Pima County Treasurer, deposits with a fiscal agent for Worker's Compensation, and deposits in the Arizona State Treasurer's LGIP. Nonparticipating interest-earning investment contracts are stated at cost. Money market investments and participating interest-earning investment contracts with a remaining maturity of one year or less at the time of purchase are stated at amortized cost. All other investments are stated at fair value.

F. Accounts Receivable

Accounts receivable primarily consist of amount of insurance claims recoveries unpaid at the end of the fiscal year. In addition, unpaid employment is 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 from the liability for unpaid claims or shown as an asset for paid claims. Because actual claims costs are dependent upon such complex factors as inflation, changes in doctrines of legal liability, exposures, and damage awards, the process used in computing claims liabilities cannot yield an exact result, particularly for liability coverages.

Claims liabilities are recomputed annually and, except for those related to environmental and unemployment, 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 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.

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 1 - Summary of Significant Accounting Policies (continued)

Employees may accumulate up to 240 hours of vacation depending upon years of service, but they forfeit any vacation hours in excess of the maximum amount that are unused at year-end. 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 most employees forfeit them upon terminating employment. However, employees who have accumulated greater than 240 hours of sick leave and are eligible to retire will receive some benefits. Employees who are eligible to retire from County service into the Arizona State Retirement System may request sick leave to be converted to annual leave on a predetermined conversion basis. An estimate of those retirement payouts is accrued as a liability in the Fund's financial statements in Employee Compensation for the current portion and under Noncurrent Liabilities for the noncurrent portion.

In addition, since vacation and sick leave used by employees within the first two pay periods after fiscal year-end is paid for with current financial resources, a compensated absences liability for these amounts is reported in the Fund's financial statements within Employee Compensation.

J. Deferred outflows and inflows of resources

The statement of net position includes separate sections for deferred outflows of resources and deferred inflows of resources. Deferred outflows of resources represent a consumption of net position that applies to future periods that will be recognized as an expense in future periods. Deferred inflows of resources represent an acquisition of net position that applies to future periods and will be recognized as a revenue in future periods.

K. Pensions

For purposes of measuring the net pension (asset and) liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the pension plan's fiduciary net position and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Note 2 - Cash and Investments

Cash and cash equivalents consist of \$16,895,126 of deposits with the County Treasurer; \$923,578 of deposits with a fiscal agent for worker's compensation; and \$51,598,724 of deposits with the State Treasurer. Deposits with the County Treasurer are available on demand and are pooled with other County monies for investment.

Fair Value Measurements – The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset.

- Level 1 inputs are quoted prices in active markets for identical assets
- Level 2 inputs are significant other observable inputs
- Level 3 inputs are significant unobservable inputs

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 2 - Cash and Investments (continued)

The State Treasurer's pools are external investment pools, the LGIP (Pool 5), LGIP – Government (Pool 7) and LGIP (Pool 500), with no regulatory oversight. The pools are not required to register (and are not registered) with the Securities and Exchange Commission (SEC). The activity and performance of the pools are reviewed monthly by the State Board of Investment. The fair value of each participant's position in the State Treasurer investment pools approximates the value of the participant's shares in the pool and the participants' shares are not identified with specific investments and are not subject to custodial credit risk. Participants in the pool are not required to categorize the value of shares in accordance with the fair value hierarchy.

The County Treasurer's pool is an external investment pool with no regulatory oversight. The pool is not required to register (and is not registered) with the SEC. The fair value of each participant's position in the County Treasurer investment pool approximates the value of the participant's shares in the pool and the participants' shares are not identified with specific investments. Participants in the pool are not required to categorize the value of shares in accordance with the fair value hierarchy.

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 412 days.

Legal Provisions – Arizona Revised Statutes (A.R.S.) authorize the County 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, notes, and other evidences of indebtedness; interest-earning investments such as savings accounts, certificates of deposit, and repurchase agreements in eligible depositories; and specified commercial paper issued by corporations organized and doing business in the United States, specified bonds, debentures, notes, and other evidences of indebtedness that are denominated in United States dollars; and certain open-end and closed-end mutual funds, including exchange traded funds. In addition, the County Treasurer may invest trust funds in certain 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 of prime quality and be rated within the top two ratings by a nationally recognized rating agency.
2. Corporate bonds, debentures, and notes must be rated within the top three ratings by a nationally recognized rating agency.
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.

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 2 - Cash and Investments (continued)

Custodial credit risk—Statutes require collateral for deposits and certificates of deposit at 102 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. The maximum maturity for investments in repurchase agreements is 180 days.

Foreign Currency Risk – Statutes do not allow foreign investments unless the investment is denominated in United States dollars.

Note 3 - Capital Assets

Capital assets are reported at actual cost (or estimated historical cost if historical records are not available). Donated assets are reported at acquisition value.

Capital asset activity for the year ended June 30, 2016, was as follows:

	Balance July 1, 2015	Increases	Decreases	Balance June 30, 2016
Capital assets not being depreciated:				
Land	\$ 448,562			\$ 448,562
Total capital assets not being depreciated	448,562			448,562
Capital assets being depreciated:				
Equipment	168,271	13,198	(13,198)	168,271
Less accumulated depreciation	(163,227)	(1,942)	198	(164,971)
Total capital assets being depreciated, net	5,044	11,256	(13,000)	3,300
Total capital assets, net	<u>\$ 453,606</u>	<u>\$ 11,256</u>	<u>\$ (13,000)</u>	<u>\$ 451,862</u>

Note 4 – Claims, Judgments and Risk Management

The Fund is liable for any single general or automobile liability claim up to \$2,500,000 per occurrence, any workers' compensation claim up to \$1,000,000 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 three fiscal years.

Payment of unemployment 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.

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

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

All of the County’s departments participate in the Fund. With the exception of environmental 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 unemployment losses are based on actual claims paid.

Claims liabilities at June 30, 2016, for each insurable area follow:

	Reported But Unpaid Losses	Incurred But Not Reported Losses	Total
General liability	\$ 14,243,764	\$ 4,598,644	\$ 18,842,408
Automobile liability	66,104	68,560	134,664
Medical malpractice	42,288	77,439	119,727
Workers' compensation	13,310,872	7,216,027	20,526,899
Environmental		1,500,000	1,500,000
Total	\$ 27,663,028	\$ 13,460,670	\$ 41,123,698

The above amounts, excluding environmental and unemployment, are reported at their present value using an expected future investment yield assumption of 2 percent.

Changes in the Fund’s claims liability amount for the years ended June 30, 2016 and 2015 were as follows:

	2016	2015
Claims liabilities - beginning	\$ 27,176,854	\$ 34,160,762
Current-year claims and changes in estimates	18,553,169	(470,259)
Claims payment	(4,606,325)	(6,513,649)
Claims liabilities balance - ending	<u>\$ 41,123,698</u>	<u>\$ 27,176,854</u>

	Balance July 1, 2015	Additions	Reductions	Balance June 30, 2016	Due within 1 year
Reported but unpaid losses	\$ 15,857,832	\$ 16,381,089	\$ (4,575,893)	\$ 27,663,028	\$ 5,007,008
Incurred but not reported	11,319,022	2,172,080	(30,432)	13,460,670	2,164,881
Total	<u>\$ 27,176,854</u>	<u>\$ 18,553,169</u>	<u>\$ (4,606,325)</u>	<u>\$ 41,123,698</u>	<u>\$ 7,171,889</u>

PIMA COUNTY, ARIZONA
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2016

Note 5 – Interfund Receivable from Other Pima County Funds

Due from other Pima County funds represents a receivable for an interfund loan payable of \$6,700,000 to the Health Benefit Trust Fund. The loan, with an original principal amount of \$10,000,000, was a reserve for the Health Benefit Trust Fund until it could establish its own reserve, with repayment beginning in 2016. These funds were deposited in the State’s LGIP Pool 500 account under the Trust’s name. However, all interest earned on the account is payable to the Self-Insurance Trust Fund. At June 30, 2016, the due from other funds represented \$7,896 in interest due from the Health Benefits Trust Fund. During fiscal year 2016, \$3,300,000 of the loan was repaid.

Administrative and Fiscal Services - For the year ended June 30, 2016, the Fund incurred expenses from Pima County for a variety of administrative and fiscal services totaling \$1,868,007. Of that amount, \$714,080 was for temporary or part-time staffing, \$841,719 was for the allocation of overhead, \$39,799 was for self-insurance premiums, \$29,474 was for motor pool charges, \$65,518 was for repairs and maintenance, \$483 was for printing and microfilming, and \$176,934 was for other miscellaneous charges.

Administration Building – The Fund occupies a portion of the east Administration Building and pays rent equivalent to its pro rata share of the building expenses incurred by the Pima County Facilities Management Department. For the year ended June 30, 2016, rent expense for the Fund totaled \$44,549.

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 \$1,388,764 has not been reported as an asset or as a liability on the Statement of Net Position as of June 30, 2016.

Note 7 – Pension and Other Postemployment Benefits

Pension 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. Although the County contributes to the Arizona State Retirement System (ASRS), the Corrections Officer Retirement Plan (CORP), the Public Safety Personnel Retirement System (PSPRS), and the Elected Officials Retirement Plan (EORP), all component units of the State of Arizona, the Fund employees only participate in the Arizona State Retirement System (ASRS).

At June 30, 2016 the Fund reported the following aggregate amounts related to pensions for which it contributes:

Net pension liabilities	\$	1,831,821
Deferred outflows of resources		175,903
Deferred inflows of resources		180,800
Pension expense		94,629

PIMA COUNTY, ARIZONA
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2016

Note 7 – Pension and Other Postemployment Benefits (continued)

The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.0 and 2.1. The ASRS issues a publicly available financial statement report that includes its financial statements and required supplementary information. The report is available on its web site at www.azasrs.gov or may be obtained by writing or calling ASRS.

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

Benefits Provided - 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. The health insurance premium benefit is paid as a fixed dollar amount per month toward 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 dependents.

State statute establishes benefit terms. Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit as follows:

	Retirement	
	Initial membership date	
	<i>Before July 1, 2011</i>	<i>On or after July 1, 2011</i>
Years of service and age required to receive benefit	Sum of years and age equals 80 10 years age 62 5 years age 50* any years age 65	30 years age 55 25 years age 60 10 years age 62 5 years age 50* any years age 65
Final average salary is based on	Highest consecutive 36 months of last 120 months	Highest consecutive 60 months of last 120 months
Benefit percent per year of service	2.1% to 2.3%	2.1% to 2.3%

* With actuarially reduced benefits

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 7 – Pension and Other Postemployment Benefits (continued)

Retirement benefits for members who joined the ASRS prior to September 13, 2013, are subject to automatic cost-of-living adjustments based on excess investment earning. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member’s death. For retired members, the survivor benefit is determined by the retirement benefit option chosen. For all other members, the beneficiary is entitled to the member’s account balance that includes the member’s contribution and employer’s contributions, plus interest earned.

Contributions — In accordance with state statutes, annual actuarial valuations determine active member and employer contribution requirements. The Arizona State Legislature establishes and may amend active plan members’ and the County’s contribution rates. The combined active member and employer contribution rates are expected to finance the costs of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the year ended June 30, 2016, active ASRS members are required by statute to contribute at the actuarially determined rate of 11.47 percent (11.35 percent for retirement and 0.12 percent for long-term disability) of the members’ annual covered payroll and the County was required by statute to contribute at the actuarially determined rate of 11.47 percent (10.85 percent for retirement, 0.50 percent for health insurance premium benefit, and 0.12 percent for long-term disability) of active members’ annual covered payroll. In addition, the County was required by statute to contribute at the actuarially determined rate of 9.36 percent (9.17 percent for retirement, 0.13 percent for health insurance, and 0.06 percent for long-term disability) of the annual covered payroll of retired members who worked for the County in positions that would typically be filled by an employee who contributes to the ASRS. The Fund’s contributions to the pension plan for the year ended June 30, 2016 was \$115,811.

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

<u>Years ended June 30,</u>	<u>Health Benefit Supplement Fund</u>	<u>Long-Term Disability Fund</u>
2016	\$ 5,482	\$ 1,316
2015	\$ 6,300	\$ 2,563
2014	\$ 6,333	\$ 2,533

Pension Liability – At June 30, 2016, the Fund reported a liability of \$1,831,821 for its proportionate share of the ASRS net pension liability. The net pension liability is measured as of June 30, 2015. The total pension liability used to calculate the net pension liability was determined using updated procedures to roll forward the total pension liability from an actuarial valuation as of June 30, 2014, to the measurement date of June 30, 2015. The Fund’s proportion of the net pension liability was based on the Fund’s actual contributions to the plan relative to the total of the County’s contributions for the year ended June 30, 2015. The Fund’s proportion measure as of June 30, 2015, was 0.47 percent, which did not significantly change from its proportion measured as of June 30, 2014.

Pension Expense and Deferred Outflows / Inflows of Resources – For the year ended June 30, 2016, the Fund recognized pension expense for \$94,629. At June 30, 2016, the Fund reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

PIMA COUNTY, ARIZONA
Self-Insurance Trust Internal Service Fund
Notes to Financial Statements
June 30, 2016

Note 7 – Pension and Other Postemployment Benefits (continued)

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 49,987	\$ 95,989
Net difference between projected and actual investment earnings on pension plan investments		58,706
Changes in proportion and differences between County contributions and proportionate share of contributions	10,105	26,105
County contributions subsequent to the measurement date	115,811	
Total	<u>\$ 175,903</u>	<u>\$ 180,800</u>

The \$115,811 reported as deferred outflows of resources relates to ASRS pensions resulting from Fund contributions subsequent to the measurement recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to ASRS pensions will be recognized in pension expense as follows:

<u>Year ending June 30</u>	
2017	\$ (42,968)
2018	(75,324)
2019	(44,794)
2020	42,378

Actuarial Assumptions – The significant actuarial assumptions used to measure the total pension liability are as follows:

Actuarial valuation date	June 30, 2014
Actuarial roll forward date	June 30, 2015
Actuarial cost method	Entry age normal
Investment rate of return	8%
Projected salary increases	3 - 6.75%
Inflation	3%
Permanent benefit increase	Included
Mortality rates	1994 GAM Scale BB

PIMA COUNTY, ARIZONA
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2016

Note 7 – Pension and Other Postemployment Benefits (continued)

Actuarial assumptions used in the June 30, 2014, valuation were based on the results of an actuarial experience study for the 5-year period ended June 30, 2012.

The long-term expected rate of return on ASRS pension plan investments was determined to be 8.79 percent using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best-estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<i>Asset Class</i>	<u><i>Target Allocation</i></u>	<u><i>Long-Term Expected Real Rate of Return</i></u>
Equity	58%	6.79%
Fixed income	25%	3.70%
Real estate	10%	4.25%
Multi-asset	5%	3.41%
Commodities	2%	3.93%
Total	100%	

Discount Rate – The discount rate used to measure the ASRS total pensions liability was 8 percent, which is less than the long-term expected rate of return of 8.79 percent. The projection of cash flows used to determine the discount rate assumed that contributions from participating employers will be made based on the actuarially determined rates based on the ASRS Board’s funding policy, which establishes the contractually required rate under Arizona statute. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the County’s Proportionate Share of the ASRS Net Pension Liability in the Discount Rate – The following table presents the County’s proportionate share of the net pension liability calculated using the discount rate of 8 percent, as well as what the County’s proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (7 percent) or 1 percentage point higher (9 percent) than the current rate.

PIMA COUNTY, ARIZONA
 Self-Insurance Trust Internal Service Fund
 Notes to Financial Statements
 June 30, 2016

Note 7 – Pension and Other Postemployment Benefits (continued)

	<i>1% Decrease (7%)</i>	<i>Current Discount Rate (8%)</i>	<i>1% Increase (9%)</i>
Fund's proportionate share of the net pension liability	\$ 2,400,311	\$ 1,831,821	\$ 1,442,218

Pension Plan Fiduciary Net Position – Detailed information about the pension plan’s fiduciary net position is available in the separately issued ASRS financial report.



**Independent Auditors' 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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Pima County Self Insurance Trust Internal Service Fund (the "Fund"), a proprietary fund of Pima County, Arizona, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's financial statements and have issued our report thereon dated, October 25, 2016.

Internal Control over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

Purpose of this Report

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

Walker & Armstrong, LLP