

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Report on Audit of Financial Statements
For the Year Ended June 30, 2010



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Board of Supervisors of Pima County, Arizona

We have audited the accompanying financial statements of the Pima Health System and Services Enterprise Fund of Pima County as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the Pima Health System and Services Enterprise Fund'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 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Pima Health System and Services Enterprise Fund's financial statements are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities and major fund of Pima County that is attributable to the Pima Health System and Services Enterprise Fund. They do not purport to, and do not, present fairly the financial position of Pima County as of June 30, 2010, and 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 the Pima Health System and Services Enterprise Fund as of June 30, 2010, and the changes in its financial position and its cash flows, for the year then ended in conformity with U.S. generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Pima Health System and Services Enterprise Fund. The accompanying financial information listed as additional information and Arizona Health Care Cost Containment System contracts in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2010, on our consideration of the Pima Health System and Services Enterprise 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* and should be considered in assessing the results of our audit.

Debbie Davenport
Auditor General

October 25, 2010

FINANCIAL STATEMENTS

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Net Assets
June 30, 2010

Assets

Current assets:

Cash and cash equivalents	\$ 35,325,598
Receivables:	
Accounts, net	426,459
Reinsurance claims	3,725,384
Grants	722,239
Interest	41,592
Due from:	
Medicare	139,682
Other Pima County funds	9,838
Inventory of supplies	81,132
Prepaid expenses	<u>236,328</u>
Total current assets	<u>40,708,252</u>

Noncurrent assets:

Capital assets:	
Leasehold improvements	900,824
Machinery and equipment	1,041,019
Intangible	381,100
Accumulated depreciation:	
Leasehold improvements	(657,989)
Machinery and equipment	(851,922)
Intangible	<u>(95,275)</u>
Capital assets, net	<u>717,757</u>
Total assets	<u>\$ 41,426,009</u>

Liabilities

Current liabilities:

Accounts payable and accrued liabilities	\$ 414,396
Accrued medical and health care claims	20,173,275
Accrued employee compensation	2,270,917
Interest payable	1,951
Deferred revenue	11,054
Due to:	
Other Pima County funds	842,786
Other governments	<u>1,565,389</u>
Total liabilities	<u>25,279,768</u>

Net Assets

Invested in capital assets	717,757
Restricted for health care	15,942,886
Unrestricted (deficit)	<u>(514,402)</u>
Total net assets	<u>\$ 16,146,241</u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2010

Operating revenues:	
Capitation	\$ 194,573,340
Reinsurance claims	8,493,466
Charges for services	2,108,835
Other	<u>2,655,531</u>
Total operating revenues	<u>207,831,172</u>
 Operating expenses:	
Medical and health care	181,306,470
Case management (contracted and salaried)	7,621,949
General, fiscal, and administrative services	4,430,707
Depreciation	243,752
Other	<u>7,066,011</u>
Total operating expenses	<u>200,668,889</u>
Operating income	<u>7,162,283</u>
 Nonoperating revenues (expenses):	
Grant revenue	4,358,043
Interest income	506,182
Interest expense	(13,855)
Premium tax	(4,117,238)
Gain on sale of capital assets	<u>1,338</u>
Total nonoperating revenues	<u>734,470</u>
Income before transfer	7,896,753
Transfer out to Pima County General Fund	<u>(1,000,000)</u>
Increase in net assets	6,896,753
Net assets, July 1, 2009	<u>9,249,488</u>
Net assets, June 30, 2010	<u><u>\$ 16,146,241</u></u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2010

Cash flows from operating activities:

Cash receipts from:

Contractors, patients and other payors	\$ 206,552,441
Other Pima County funds for goods and services	160,631
Miscellaneous operations	2,655,531

Cash payments to:

Providers for health care services	(164,858,699)
Employees for services	(28,572,735)
Other Pima County funds for goods and services	(5,453,043)

Net cash provided by operating activities	10,484,126
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Cash flows from noncapital financing activities:

Cash transfer out to Pima County General Fund	(1,000,000)
Loans with other Pima County funds	(169,739)
Interest paid on short-term credit	(14,628)
Grant receipts	4,532,780
Premium tax payments	(4,117,238)

Net cash used for noncapital financing activities	(768,825)
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Cash flows from capital and related financing activities:

Proceeds from sale of capital assets	1,338
Purchase of capital assets	(206,948)

Net cash used for capital and related financing activities	(205,610)
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Cash flow from investing activities:

Interest received on cash and investments	581,444
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Net cash provided by investing activities	581,444
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Net increase in cash and cash equivalents	10,091,135
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Cash and cash equivalents, July 1, 2009	25,234,463
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Cash and cash equivalents, June 30, 2010	\$ 35,325,598
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(continued)

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2010

(continued)

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

Operating income	\$	7,162,283
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		243,752
Decrease (increase) in assets		
Accounts receivable		1,013,482
Reinsurance claims receivable		2,589,175
Due from Medicare		2,726
Inventory of supplies		8,211
Prepaid expenses		(225,092)
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities		(262,630)
Accrued medical and health care claims		2,094,806
Accrued employee compensation		(74,635)
Due to other governments		(2,078,052)
Deferred revenue		10,100
Net cash provided by operating activities	\$	<u>10,484,126</u>

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies

The accounting policies of Pima County (County) and its Pima Health System and Services Enterprise 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 enterprise fund of Pima County, Arizona and the ultimate financial accountability for the Fund remains with Pima County. The Fund's management is responsible for overseeing the operations of Pima Health System (the AHCCCS contracts), Posada del Sol Nursing Home, the Grants and Community Services System, and other Pima County programs, whose activities are included in the accompanying financial statements.

The financial statements present only the Pima Health System and Services Enterprise Fund and are not intended to present the balances and activity of Pima County or its business-type activities and enterprise funds. The County and Pima Health System and Services is a contractor with the Arizona Health Care Cost Containment System (AHCCCS) to provide health care services to eligible enrollees of the AHCCCS Ambulatory and Arizona Long-Term Care System (ALTCS) programs. The Ambulatory program provides both inpatient and outpatient medical and nursing services to eligible enrollees of the Ambulatory program. The ALTCS program provides inpatient and outpatient medical and nursing services in addition to managed institutional and home- and community-based long-term care services to eligible enrollees of the ALTCS program. The Fund also provides long-term care services to Posada del Sol Nursing Home residents who are primarily ALTCS enrollees. The Fund receives monthly premiums from AHCCCS for all eligible enrollees under the respective Ambulatory and ALTCS programs.

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 the 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 an enterprise fund because its operations are financed and operated in a manner similar to private business enterprises. It is the intent of the Pima County Board of Supervisors that the costs (expenses including depreciation) of goods or services provided by the Fund on a continuing basis be financed or recovered primarily through contractual agreements and 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 Fund are recorded in the appropriate revenue or expense accounts. Intrafund transactions within the Fund are eliminated for the financial statement presentation.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

Unless they conflict with GASB pronouncements, the Fund follows Financial Accounting Standards 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 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 result from exchange transactions. Accordingly, capitation and other charges generated by the Fund for providing health care services are considered to be operating revenues. Other revenues used for health care, such as grants and interest earnings, are not generated from exchange transactions and are considered to be nonoperating revenues. Operating expenses include the costs of providing health care services, administrative expenses, and depreciation on capital assets. Other expenses, such as interest expense and AHCCCS premium taxes are considered to be nonoperating expenses.

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. Capitation Receipts

The Fund receives from AHCCCS fixed capitation payments, generally in advance, based on certain rates for each AHCCCS member enrolled with the Fund. The Fund is required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the Fund retains the funds as profit; if the costs are higher than the amount of capitation payments from AHCCCS, the Fund absorbs the loss. The Fund may recover certain losses for those cases eligible for reinsurance payments. Capitation premiums are recognized in accordance with the Fund's contract with AHCCCS.

Capitation is paid prospectively as well as for prior period coverage (PPC). The PPC period is from the first day of the month of application to the time of enrollment with a contracted health plan. The risk under PPC is shared by both the Fund and AHCCCS for the contract year ended September 30, 2010. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the year. The reconciliation limits the contractor's profits and losses to 2%. Except for Title XIX waiver members, effective October 1, 2002, the PPC rates were adjusted and the reconciliation of PPC costs was not performed for the contract year ended September 30, 2003. The PPC reconciliation was reinstated for the contract year ended September 30, 2004 and thereafter. At June 30, 2010, the Fund has \$260,694 of estimated settlement payments due to AHCCCS for the PPC reconciliation for contract years 2009 and 2010. The PPC 2008 contract year settlement closed during the fiscal year ending June 30, 2010. The accrued liability recorded in anticipation of this settlement (as of June 30, 2009) was in excess of the actual settlement by \$1,271,796. This excess accrued liability was eliminated and other operating revenue was increased in the accompanying Statement of Revenues, Expenses and Changes in Net Assets.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

Additional capitation payments from AHCCCS include the Home and Community-Based Services (HCBS) Mix reconciliation. The HCBS Mix reconciliation is designed to limit the risk for both the Fund and AHCCCS of placement assumptions utilized in creating capitation rates. When computing capitation rates, AHCCCS assumes a certain percentage of members will be living in an HCBS setting as compared to a nursing facility. The accuracy of this assumption can materially affect the Fund's profitability. At June 30, 2010, the Fund has \$1,770,484 of estimated settlement payments due to AHCCCS for the HCBS Mix reconciliation for contract years 2009 and 2010.

F. Reinsurance Receipts

AHCCCS provides a stop-loss reinsurance program for the Fund for partial reimbursement of reinsurable covered medical services incurred for members with an acute medical condition. The program includes a deductible, which varies based on the Fund's enrollment and the eligibility category of the members. AHCCCS reimburses the Fund based on a coinsurance amount for reinsurable covered services incurred above the deductible.

The reinsurance program includes reinsurance reimbursement for covered organ transplantation. The reinsurance program also includes a special catastrophic reinsurance program which covers conditions such as certain traumatic brain injuries and certain blood related disorders. There is no deductible for catastrophic reinsurance cases and AHCCCS reimburses the Fund at a percentage of the Fund's paid amount, less the coinsurance amount, unless the costs are paid under a subcapitated arrangement. AHCCCS pays 85% (75% for traumatic brain injuries) of the Fund's paid amount up to \$650,000 and 100% thereafter for catastrophic reinsurance. Regular reinsurance provides partial reimbursement of reinsurance eligible covered services and AHCCCS will reimburse 75% of eligible costs above a certain deductible level. The deductible is the responsibility of the program contractor. For transplants, payment is limited to 85% of the AHCCCS contract amount for the transplant services rendered or 85% of the Fund's paid amount, whichever is lower.

Reinsurance claims receivable result from additional payments from the AHCCCS Administration to the Fund for certain enrollees whose qualifying medical expenses paid by the Fund during the year ended June 30, 2010, were in excess of specified deductible limits. Reinsurance claims receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to reinsurance claims receivable based on its assessment of the current status of individual balances. Balances which are still outstanding after management has used reasonable collection efforts are also written off through a charge to earnings and a credit to reinsurance claims receivable. Reinsurance claims receivable at June 30, 2010 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

G. Share of Costs

The Fund's members covered under the ALTCS program that do not meet certain eligibility criteria are required to pay for a portion of the care they receive. AHCCCS reduces the contracted capitation rate with the Fund by the estimated amount of participant shared costs. After contract year end, AHCCCS analyzes the amount that the Fund should have received from members for share of costs. If the Fund receives less money from the participants in payment of their share of the costs than AHCCCS anticipated, AHCCCS reimburses the Fund for the difference. The share of costs receivables are based on contract year which runs from October 1 to September 30. At June 30, 2010, the Fund had approximately \$736,140 due from AHCCCS related to share of costs. This amount is comprised of \$318,404 and \$417,736 due from AHCCCS for contract years 2009 and 2010 respectively. These amounts are netted with other accounts due to and from other governments, and are included in the overall amount due to other governments in the accompanying Statement of Net Assets.

Share of cost receivables are based on assumptions and estimates, and while management believes the receivable is reasonable, the ultimate share of cost payment for the 2009 through 2010 contract years may be less than or in excess of an amount estimated once AHCCCS completes the contract year reconciliations. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the share of cost receivables based on its assessment

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

of the current status of individual balances. Balances which are still outstanding after management has used reasonable collection efforts are also written off through a charge to earnings and a credit to share of costs receivable. Share of costs receivable at June 30, 2010 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

H. Grant Revenues

Grants and assistance awards made on the basis of entitlement periods are recorded as grants receivable and revenues when entitlement occurs. Reimbursement grants are recorded as grants receivable and revenues as soon as all eligibility requirements have been met. Funding sources may, at their discretion, request reimbursement for expenses or return of funds, or both, if the Fund does not comply with the terms of the contract.

I. Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and cash and investments held by the Pima County Treasurer, in an investment pool. All investments are stated at fair value.

J. Accounts and Grants Receivable

Accounts receivable consist primarily of amounts due from third-party payers, providers for health care services provided to patients and recoupment from providers. Grants receivable consist primarily of amounts due directly from government agencies or passed through the Pima Council on Aging. These balances are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

At June 30, 2010, accounts receivable was net of an allowance for doubtful accounts of \$343,783. Grants receivable at June 30, 2010 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

K. Due to Other Governments

Due to other governments consists of amounts due to AHCCCS based on contractual agreement provisions of the Ambulatory and ALTCS programs. The largest component relates to the HCBS Mix reconciliation (see E).

L. Inventory of Supplies

Inventories consist of medical supplies and are recorded as assets when purchased and expensed when consumed. These inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

M. Capital Assets

Purchased capital assets are capitalized at cost. Donated assets are capitalized at their estimated fair market value on the date received. The Fund capitalizes all land regardless of cost, buildings valued at \$100,000 and above and all machinery and equipment valued at \$5,000 and above. Depreciation of assets is charged as an expense against operations.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

Assets are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building improvements	7-10 years
Machinery and equipment	5-15 years
Intangibles	5 years

N. Medical and Health Care Claims Payable

The Fund is responsible for the cost of providing medical services on a fee-for-service basis to a majority of the health care service providers through which it contracts with the exception of three providers that have negotiated sub-capitation agreements. The Fund paid \$37,226 to these sub-capitated providers during fiscal year 2010.

In the accompanying financial statements, medical and health care claims expense includes claims paid, claims in process and pending, and the estimate made by management for incurred but not reported (IBNR) programmatic claims. These IBNR programmatic claims include charges by physicians, hospitals and other health care providers for services rendered to eligible members during the period for which claims have not yet been submitted.

The estimates for IBNR programmatic claims are developed using methods based upon historical data for payment patterns and other relevant factors. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and adjustments are reflected in the period determined.

At June 30, 2010, medical and health care claims payable consists of estimates of \$18,137,905 in the ALTCS program, \$1,288,478 in the Ambulatory program and \$746,892 in the Grants and Community Service System.

O. 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 year-end are forfeited. Upon termination of employment, all unused and un-forfeited 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 of sick hours. 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 into the Arizona State Retirement System, Public Safety Personnel Retirement Plan, 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.

P. Taxes

The Fund is an enterprise fund of Pima County and is not subject to income taxes. However, payments from AHCCCS for acute care, ventilator dependent care, and ALTCS care are subject to a premium tax of 2%. Total premium tax expense for the year ended June 30, 2010 was \$4,117,238 which is included in the non-operating expenses portion of the accompanying Statement of Revenues, Expenses and Changes in Net Assets. The Fund has \$20,350 due to the Arizona Department of Insurance at June 30, 2010. This amount is included in the due to other governments in the accompanying Statement of Net Assets.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

Q. Management's Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at June 30, 2010, and the reported amounts of revenues and expenses during the fiscal year then ended. Actual results may differ from these estimates.

Note 2 - Cash and Investments

Cash and cash equivalents at June 30, 2010 were as follows:

Cash on hand	\$ 2,500
Cash and investments in the Pima County Treasurer's Investment pool	<u>35,323,098</u>
Total	<u>\$ 35,325,598</u>

Cash and investments in the Pima County Treasurer's investment pool represent a portion of the County Treasurer's pool portfolio. The pool's structure does not provide for shares. The Fund's portion in the pool is not identified with specific investments. Investment income is allocated to the Fund on a pro-rata basis.

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. The Pima County Treasurer's investment pool is unrated.

Interest rate risk – Interest rate risk is the risk that changes in interest rates will adversely affect an investment's fair value. The County does not have a formal investment policy with respect to interest rate risk. The Pima County Treasurer's investment pool had a weighted average maturity of 177 days at June 30, 2010.

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 – Arizona Revised 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 or their successors.
2. Corporate bonds, debentures, and notes must be rated A or better by Moody's investors service or Standard and Poor's rating service or their successors.
3. Fixed income securities must carry one of the two highest ratings by Moody's investors service and Standard and Poor's rating service or their successors. If only one of the above-mentioned services rates the security, it must carry the highest rating of that service. If a rating change occurs after purchase, it is not mandatory to sell the security.

Custodial credit risk – Arizona Revised 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 – Arizona Revised Statutes do not include any requirements for concentration of credit risk.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 2 - Cash and Investments (continued)

Interest rate risk – Arizona Revised 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. Investments in repurchase agreements must have a maximum maturity of 180 days.

Foreign currency risk – Arizona Revised Statutes do not allow foreign investments.

Note 3 - Capital Assets

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

	<u>July 1, 2009</u> <u>Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2010</u> <u>Balance</u>
Leasehold improvements	\$ 693,876	\$ 206,948		\$ 900,824
Accumulated depreciation	<u>(610,462)</u>	<u>(47,527)</u>		<u>(657,989)</u>
Net leasehold improvements	<u>83,414</u>	<u>159,421</u>		<u>242,835</u>
Machinery and equipment	1,054,594		\$ (13,575)	1,041,019
Accumulated depreciation	<u>(745,492)</u>	<u>(120,005)</u>	<u>13,575</u>	<u>(851,922)</u>
Net machinery and equipment	<u>309,102</u>	<u>(120,005)</u>		<u>189,097</u>
Intangibles	381,100			381,100
Accumulated depreciation	<u>(19,055)</u>	<u>(76,220)</u>		<u>(95,275)</u>
Net intangibles	<u>362,045</u>	<u>(76,220)</u>		<u>285,825</u>
Capital assets, net	<u>\$ 754,561</u>	<u>\$ (36,804)</u>	<u>\$ _____</u>	<u>\$ 717,757</u>

Note 4 - Claims, Judgments and Risk Management

Compliance with Laws and Regulations – The Fund is subject to numerous laws, regulations and oversight by the state and federal governments. These laws and regulations include, but are not necessarily limited to, matters such as government health care program participation requirements, reimbursement for member services and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant financial sanctions. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown at this time.

The Fund has received final notices from AHCCCS of possible sanctions for each quarter, in fiscal year 2010. The sanctions are a result of pended encounters. As of June 30, 2010, there were 39,888 pended encounters with associated sanction amounts of \$564,130. It is unknown whether pended encounters were due to the Fund's or AHCCCS' system issues and AHCCCS has preliminarily waived the monetary sanctions as of June 30, 2010. The sanctions could be re-imposed if the Fund is unable to adjudicate all pended encounters once AHCCCS system issues are corrected. Fund management does not believe these sanctions will be re-imposed.

Self-insurance - The Fund is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; medical malpractice; and natural disasters. The Fund is a participant in Pima County's self-insurance program, and in the opinion of the Fund's management, that self-insurance program would cover any unfavorable outcomes from these risks. Accordingly, the Fund has no risk of loss beyond adjustments to future years' premium payments to Pima County's self-insurance program. All estimated losses for unsettled claims and actions of the Fund are determined on an actuarial basis and are included in the *Pima County Comprehensive Annual Financial Report*. As of June 30, 2010, the Fund incurred \$805,926 in self-insurance expense,

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

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

of which \$264,196 is included in other operating expenses and \$541,730 in medical and health care claims, in the accompanying Statement of Revenues, Expenses and Changes in Net Assets.

Medical Malpractice - The Fund has obtained modified claims-made insurance policies to cover medical malpractice claims. Deductibles are the responsibility of Pima County through Risk Management and are \$1,000,000 per occurrence with an annual aggregate self insurance retention of \$5,000,000. The Fund's primary medical malpractice policy has a retroactive date of June 26, 1993. Settled claims have not exceeded insurance coverage in any of the prior three fiscal years.

Note 5 - Related Party Transactions

During the course of its operations, the Fund had numerous transactions with other Pima County funds to finance operations and provide services. During the year ended June 30, 2010, the Fund received capitation revenues totaling \$102,000 from Pima County departments for services provided to Pima County patients and other income totaling \$58,631 for claims processing services. The Fund incurred expenses totaling \$5,853,643 for the allocation of overhead, insurance premiums, and other charges for miscellaneous supplies and services from Pima County.

Of the \$842,786 balance in due to other Pima County funds, \$815,911 represents advances received from other County funds to eliminate cash overdrafts in the Fund's following programs:

Grants/Community Services System	\$	362,760
Other Pima County Programs		<u>453,151</u>
Total	\$	<u>815,911</u>

The remaining \$26,875 was for miscellaneous services.

Note 6 - Retirement Plan

Plan Descriptions—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. The ASRS issues a publicly available financial report that may be obtained by writing or calling:

ASRS
3300 N. Central Avenue
P. O. Box 33910
Phoenix, AZ 85067-3910
(602) 240-2000 or 1-800-621-3778

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.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2010

Note 6 - Retirement Plan (continued)

The County'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>Retirement Fund</u>	<u>Health Benefit Supplement Fund</u>	<u>Long-Term Disability Fund</u>
2010	\$ 1,779,021	\$ 140,786	\$ 85,325
2009	\$ 1,960,018	\$ 235,496	\$ 122,654
2008	\$ 2,395,671	\$ 312,479	\$ 148,799

Note 7 - Capitation

For the year ended June 30, 2010, capitation revenues consist of the following amounts:

ALTCS long-term care	\$ 190,727,541
AHCCCS ambulatory/acute care	3,845,799
Total	<u>\$ 194,573,340</u>

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Combining Statement of Net Assets by Program
June 30, 2010

	AHCCCS				
	Ambulatory Contracts	Long-Term Care Contracts (1)	Grants/ Community Services System	Other Pima County Programs	Total
Assets					
Current assets:					
Cash and cash equivalents	\$ 5,250,052	\$ 30,074,546		\$ 1,000	\$ 35,325,598
Receivables:					
Accounts, net	245,489	66,896		114,074	426,459
Reinsurance claims	226,006	3,499,378			3,725,384
Grants			\$ 722,239		722,239
Interest	5,782	35,810			41,592
Due from:					
Medicare		139,682			139,682
Other Pima County funds		8,500		1,338	9,838
Inventory of supplies		81,132			81,132
Prepaid expenses				236,328	236,328
Total current assets	<u>\$ 5,727,329</u>	<u>\$ 33,905,944</u>	<u>\$ 722,239</u>	<u>\$ 352,740</u>	<u>\$ 40,708,252</u>
Noncurrent assets:					
Capital assets:					
Leasehold improvements				900,824	900,824
Machinery and equipment				1,041,019	1,041,019
Intangible				381,100	381,100
Accumulated depreciation:					
Leasehold improvements				(657,989)	(657,989)
Machinery and equipment				(851,922)	(851,922)
Intangible				(95,275)	(95,275)
Capital assets, net				<u>717,757</u>	<u>717,757</u>
Total assets	<u>\$ 5,727,329</u>	<u>\$ 33,905,944</u>	<u>\$ 722,239</u>	<u>\$ 1,070,497</u>	<u>\$ 41,426,009</u>
Liabilities					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 24,966	\$ 386,856	\$ 2,574	\$	\$ 414,396
Accrued medical and health care claims	1,288,478	18,137,905	746,892		20,173,275
Accrued employee compensation	3,946	2,254,488	12,483		2,270,917
Interest payable		1,660	291		1,951
Deferred revenue			554	10,500	11,054
Due to:					
Other Pima County funds		26,699	362,760	453,327	842,786
Other governments	284,455	1,280,934			1,565,389
Total liabilities	<u>1,601,845</u>	<u>22,088,542</u>	<u>1,125,554</u>	<u>463,827</u>	<u>25,279,768</u>
Net Assets (Deficit)					
Invested in capital assets				717,757	717,757
Restricted for health care	4,125,484	11,817,402			15,942,886
Unrestricted (deficit)			(403,315)	(111,087)	(514,402)
Total net assets (deficit)	<u>\$ 4,125,484</u>	<u>\$ 11,817,402</u>	<u>\$ (403,315)</u>	<u>\$ 606,670</u>	<u>\$ 16,146,241</u>

(1) The financial position of the Posada del Sol Nursing Home and the ALTCS Contracts have been combined and are reported as the Long-Term Care Contracts program. The combination is presented on page 26.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Combining Statement of Revenues, Expenses and Changes in Net Assets by Program
Year Ended June 30, 2010

	AHCCCS					Total
	Ambulatory Contracts	Long-Term Care Contracts (1)	Grants/ Community Services System	Other Pima County Programs	Intrafund Eliminations	
Operating revenues:						
Capitation	\$ 3,845,799	\$ 190,727,541				\$ 194,573,340
Reinsurance claims	719,701	7,773,765				8,493,466
Charges for services		2,109,415			\$ (580)	2,108,835
Other	1,670,763	842,706		\$ 385,814	(243,752)	2,655,531
Total operating revenues	<u>6,236,263</u>	<u>201,453,427</u>		<u>385,814</u>	<u>(244,332)</u>	<u>207,831,172</u>
Operating expenses:						
Medical and health care	2,994,949	175,059,212	\$ 3,250,477	2,412	(580)	181,306,470
Case management (contracted and salaried)		6,467,174	1,154,775			7,621,949
General, fiscal, and administrative services	88,386	3,997,252	335,499	9,570		4,430,707
Depreciation				243,752		243,752
Other	194,566	7,095,450	6,752	12,995	(243,752)	7,066,011
Total operating expenses	<u>3,277,901</u>	<u>192,619,088</u>	<u>4,747,503</u>	<u>268,729</u>	<u>(244,332)</u>	<u>200,668,889</u>
Operating income (loss)	2,958,362	8,834,339	(4,747,503)	117,085		7,162,283
Nonoperating revenues (expenses):						
Grant revenue			4,358,043			4,358,043
Interest income	42,654	463,528				506,182
Interest expense			(13,855)			(13,855)
Premium tax	(118,357)	(3,998,881)				(4,117,238)
Gain on sale of capital assets				1,338		1,338
Total nonoperating revenues (expenses), net	<u>(75,703)</u>	<u>(3,535,353)</u>	<u>4,344,188</u>	<u>1,338</u>		<u>734,470</u>
Income (loss) before transfers	2,882,659	5,298,986	(403,315)	118,423		7,896,753
Transfers in			255,801		(255,801)	
Transfers out	(1,000,000)	(255,801)			255,801	(1,000,000)
Increase (decrease) in net assets	1,882,659	5,043,185	(147,514)	118,423		6,896,753
Net assets (deficit), July 1, 2009	2,242,825	6,774,217	(255,801)	488,247		9,249,488
Net assets (deficit), June 30, 2010	<u>\$ 4,125,484</u>	<u>\$ 11,817,402</u>	<u>\$ (403,315)</u>	<u>\$ 606,670</u>	<u>\$</u>	<u>\$ 16,146,241</u>

(1) The financial positions of the Posada del Sol Nursing Home and the ALTCS Contracts have been combined and are reported as the Long-Term Care Contracts program. The combination is presented on page 27.