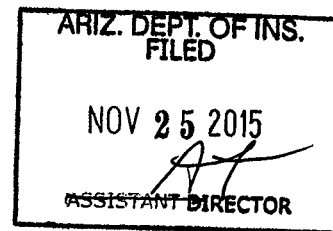




Department of Insurance
State of Arizona
Financial Affairs Division -Examinations



REPORT OF EXAMINATION

of the

ARIZONA PUBLIC EMPLOYERS HEALTH POOL

(A Public Agency Risk Pool)

PHOENIX, ARIZONA

as of

June 30, 2012

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**Douglas A. Ducey, Governor
Darren T. Ellingson, Acting Director**

Phoenix, Arizona
October 8, 2015

Honorable Darren T. Ellingson
Acting Director of Insurance
State of Arizona
2910 North 44th Street, Suite 210
Phoenix, Arizona 85018-7269

Dear Acting Director Ellingson:

Pursuant to your instructions and in conformity with the provisions of A.R.S. § 11-952.01, an examination has been made of the administrative affairs, books, records and financial condition of the

Arizona Public Employers Health Pool
333 East Osborn Road Suite 300
Phoenix, Arizona 85012

hereinafter referred to as the "Pool," at its administrative office in Phoenix, Arizona.

The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

This examination covers the period from July 1, 2007, to June 30, 2012, with a review of such prior and subsequent transactions as deemed necessary. The Pool was organized as a public agency risk retention pool in accordance with A.R.S. § 11-952.01. The Pool accounts for and reports its financial condition in accordance with generally accepted accounting principles ("GAAP") for governmental bodies and risk retention pools as applicable. The Governmental Accounting Standards Board is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The primary purpose of this examination is to evaluate and report upon whether the assets of the Pool are sufficient to discharge its legal liabilities and other obligations pursuant to A.R.S. § 11-952.01(N).

Pursuant to A.R.S. § 11-952.01(M), the Pool is required to file with the Arizona Department of Insurance ("ADOI") an annual financial statement audited by a certified public accountant ("CPA"). The CPA's audit workpapers were reviewed as part of this examination and, where possible, reliance was placed upon the audit work of the CPA. Included in the financial statements to this Report of Examination are actuarially determined estimates of certain reserve liabilities, which were evaluated for adequacy by an actuary representing the Pool.

HISTORY

The Pool was incorporated in the State of Arizona in June 1985 as a not-for-profit entity and was organized as a risk-retention pool to provide employee health benefits through the execution of an Intergovernmental Agreement (IGA), entered into between the founding members Clarkdale Jerome School District, Cottonwood-Oak Creek School District, and Sedona-Oak Creek School District (hereinafter referred to as the Members) pursuant to A.R.S § 11-952.01.

In 2003, the Pool replaced the IGA agreement by the Membership/Participation Agreement. Refer to the caption "Membership/Participation Agreement" in this Report of Examination.

In 2001, 2003, and 2010, the Pool changed its name and obtained approval from the Arizona Corporation Commission. The last approval was as of May 25, 2010.

NET ASSETS

The Pool is not subject to the minimum capital, surplus or net asset requirements. The Pool is funded solely through the payment of contributions (premiums) by its members and participants. The contributions are calculated by the Pool administrator in accordance with an experience rating formula determined by the Board of Trustees, and based, in part, on annual evaluations and recommendations of its actuary. The total required contribution is allocated to the members and participants in proportion to their exposure as it relates to the total exposure of the Pool. Broadly speaking, the Pool collects contributions and then pays associated claims (benefits) and expenses, and any funds remaining after accounting for claims and expenses are reflected in its financial statements as Net Assets (akin to Retained Earnings in "for profit" financial statements). As of June 30, 2012, the Pool reported a net assets available (surplus) balance of approximately \$5.5 million.

The Board of Trustees may declare special assessments to cure any deficiency resulting from an excess of liabilities over assets in the Pool. The amount of any assessment may not exceed a Member's annual contribution in the year the assessment is made, and only one such additional assessment may be declared in any fiscal year.

In the event that a Member terminates their participation in the Pool, the Member shall forfeit any and all rights to the return of any surplus, unearned contributions, or other legally permitted distributions from the Pool.

Upon termination of the Pool, an adequate provision shall be made for all pending and anticipated claims, then the assets of the Pool shall be liquidated, a final accounting made, and the assets thereafter remaining in the Pool shall be distributed among the then-existing Members of the Pool.

MANAGEMENT AND CONTROL

The ADOI does not have regulatory authority over the Pool, except that the ADOI is tasked with examining the Pool for solvency at least once every 5-years. A clear understanding of the Pool's organizational, governance and control environments is essential for sound solvency assessment and monitoring. The Members are responsible for the governance and management of the Pool.

Control of the Pool is vested in its Board of Trustees. The number and election of Trustees is defined in the Pool's Bylaws and Articles of Incorporation, which indicate that the Board of Trustees shall be classified so that each Trustee shall serve a term of three years and so that the term of approximately one-third of the entire number of Trustees shall expire annually (creating three tiers of Trustees).

The Pool does not have any direct employees and the day-to-day operations, along with claims processing, investment management, and actuarial services are procured through contracts with third parties.

Trustees

The following persons were serving in the capacity of Trustee at June 30, 2012:

TIER 1 Expires: 2014	TIER 2 Expires: 2015	TIER 3 Expires: 2016
David Lykins , Superintendent Sedona-Oak Creek School District, 221 Brewer Rd, Ste 100, Sedona, AZ 86336	Barbara U'Ren , Superintendent , Cottonwood Oak-Creek School District, 1 N. Willard Cottonwood, AZ 86326	Rudy Rodriquez , Finance Director, City of Cottonwood , 827 North Main Street, Cottonwood, AZ 86326
Tim Ernster , City Manager City of Sedona, 102 Roadrunner Dr, Sedona, AZ 86336	Jimmy Jayne , County Manager Navajo County PO Box 668, Holbrook, AZ 86025	Kathleen Fleenor , Superintendent, Clarkdale Jerome School District, 1615 Main St., Clarkdate, AZ 86324

Officers

The following persons were serving as officers at June 30, 2012:

Rudy Rodriguez	President
Kathleen Fleenor	Vice President
Barbara U'Ren	Secretary & Treasurer

Conflicts of Interest

The Board of Trustees and Officers have signed an acknowledgement of receipt of conflict of interest policy. No conflict of interests have been disclosed or noted by this Examination.

Contracts

As of June 30, 2012, the Board of Trustees approved the following contracts entered into by the Pool in the conduct of its business operation:

1. **Ashton Tiffany, LLC (AT), effective July 1, 2002**, for the management of the overall day-to-day operations of the Pool. Either party may terminate the agreement by giving the other party thirty days prior written notice of termination.
2. **AmeriBen Solutions, Inc. (AmeriBen), effective January 1, 2005**, for the administration of the health claim employee benefit programs. Either party may terminate this agreement by giving the other not less than ninety days written notice.
3. **American Health Group, Inc. (AHG), effective January 1, 2007**, for certain health care cost containment management services. Either party may terminate this agreement by written notice at least ninety days prior to the renewal anniversary date of this agreement.
4. **InformdRx, Inc. (Irx), k/n/a Catamaran, effective July 1, 2010**, for the management of the prescription benefit programs. This includes dispensing of prescription drugs by and through a network of retail community pharmacies and mail service pharmacies. Either party may terminate this agreement by giving the other not less than ninety days written notice.
5. **Delta Dental Plan of Arizona, Inc. (Delta), effective July 1, 1988**, for the administration of the dental claim employee benefit programs. Either party may terminate this agreement by giving the other not less than ninety days written notice.
6. **The Segal Company (Segal), effective July 1, 2002**, for the management of the annual reports, claim experience analysis, and other similar management functions. Either party may terminate the agreement by giving the other party thirty days prior written notice of termination.
7. **Claremont Capital, LLC, (Claremont), effective August 26, 2004**, for the management of the investment portfolio of the Pool. Claremont is an SEC registered investment advisor and a privately held company in Phoenix, Arizona. Under the terms of the agreement, Claremont is authorized to manage those assets placed on account in accordance with investment policies and

procedures approved by the Board of Trustees. Either party may terminate the agreement by giving the other party thirty days prior written notice of termination.

8. **Wells Fargo Bank N.A. (WFB), effective September 19, 2008**, for the investment custodial services. Either party may terminate the agreement by giving the other party thirty days prior written notice of termination.

In the ordinary course of business, the Pool entered other agreements in the conduct of its business operation.

TERRITORY AND PLAN OF OPERATION

The Pool is a self-insured employee benefits pool established pursuant to ARS 11-952.01 that provides health benefits and services to Member public agencies in the State of Arizona. The general nature of the business is to enter into contracts pursuant to the provisions of ARS 11-952.01, for the joint purchase of life insurance, disability insurance, accident insurance, or health benefits plan insurance, and to pool retention of such risks.

The pool offers a comprehensive health benefits program, including medical, dental, prescription, life, voluntary life and vision plan. In addition, the Pool offers supplemental programs such as a Flexible Spending Accounts (FSA), Health Savings Accounts (HSA) and pharmacy benefit programs. Medical and prescription benefits are provided through a combination of self-insurance and stop loss insurance purchased from an independent insurance carrier. Dental benefits are fully self-insured by the pool. Life, voluntary life, and vision is fully insured and made available through a third party insurance entity.

Specific Stop Loss

For the period ending June 30, 2012, the Pool obtained specific stop loss coverage from Matrix Group Benefits, LLC, the policy is issued by ACE American Insurance Company (ACE). ACE's policy covers medical and pharmacy. The policy is subject to an annual specific deductible per individual of \$250,000, a maximum annual reimbursement of \$1,750,000, a specific percentage reimbursement after deductible of 100%, and an aggregate specific corridor of \$25,000.

The Pool remains contingently liable for losses sustained within its contractual policy limits and for which its procured stop loss carrier is unwilling or unable to pay. The Pool has not reported any significant disputes with its stop loss carrier. As of June 30, 2012, ACE's core operating insurance companies maintain financial strength rating of AA- (Very Strong) from S&P and A+ (Superior) from A.M. Best.

Preferred Provider Network

For the period ending June 30, 2012, the Pool contracted with Blue Cross and Blue Shield of Arizona, Inc. (BCBSAZ) and Mayo Clinic, in order to establish a network of participating health care providers to provide covered services pursuant to the benefit materials issued to the plan participants.

For BCBSAZ, the Pool's health care delivery system consists of physicians, hospitals and other ancillary providers that have executed subcontracts with BCBSAZ for which the Pool is the designated payor of benefits. Each subcontracted provider agrees to look only to the Pool for the payment for covered services, except for applicable copayments, deductibles and coinsurance. The agreement with BCBSAZ appears to be standard as to form and calls for compensation to be paid in accordance with fee schedules attached as exhibits to the agreement.

For Mayo Clinic, the physicians and ancillary providers are all typically employed directly by Mayo Clinic. The pool is the designated payor of benefits. The agreement with Mayo Clinic appears to be a standard form and calls for compensation to be paid in accordance with fee schedules attached as exhibits to the agreement.

GROWTH OF THE POOL

The following significant data reflects the growth of the Pool, as taken from its financial statements and records for the years indicated:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets	\$ 8,959,209	\$ 7,569,256	\$ 6,623,092	\$ 5,073,634	\$ 5,554,014
Unrestricted net assets	5,530,326	4,793,040	4,251,698	3,667,688	4,289,591
Increase in net assets	737,286	541,342	584,010	(621,903)	83,339
Gross contributions	14,951,927	14,286,154	11,983,685	6,435,560	6,113,269
Net contributions	14,100,527	13,535,129	11,297,273	5,972,227	5,656,641

ACCOUNTS AND RECORDS

General Accounting

The Pool maintains a computerized general ledger, general journal, cash disbursements and receipts journals and related supporting records. The Pool's monthly compilation was prepared by the firm of R.C. Acosta & Associates through December 31, 2011. Effective January 1, 2012, Ashton Tiffany, LLC began preparing the monthly compilations. In addition, Ashton Tiffany, LLC is responsible for the daily accounting and administrative functions. Claim payments are provided by the firm of IEC Group, Inc., dba AmeriBen / IEC Group (AmeriBen).

Independent Accountants

The firm of CliftonLarsonAllen, CPA, LLP, Phoenix, Arizona, was retained by the Pool to audit its balance sheet and the related statements of revenues and expenses, changes in net assets and cash flows for the years ending June 30, 2012. The audited financial statements were prepared in accordance with auditing standards generally accepted in the United States of America for risk retention pools as applicable, and contained an unqualified opinion.

The firm of Clifton Gunderson, CPA, LLP, Phoenix, Arizona audited the financial statements as of June 30, 2011 and 2010, which contained an unqualified opinion.

The firm of Brian R. Lee, CPA, P.C., Phoenix, Arizona audited the financial statements as of June 30, 2009 and 2008, which contained an unqualified opinion.

Actuarial Opinion

The claim liabilities of the Pool were reviewed by Gary L. Petersen, F.C.A., A.S.A., M.A.A.A., Vice President Consulting actuary with The Segal Company, who issued a statement of actuarial opinion that relied on information supplied by the Pool to formulate an opinion regarding the outstanding claims obligations of the Pool's self-insurance program as of June 30, 2012, and to determine the adequacy of funds held to pay these outstanding liabilities. The identified actuarial items at June 30, 2012, are:

<u>IBNR Liability</u>	<u>June 30, 2012</u>
Medical	\$ 1,863,000
Prescription Drugs	74,000
Dental	38,000
Margin	100,000 (1)
Total IBNR Liability	<u>\$ 2,075,000</u>

Footnote:

(1) = The Pool established a reserve for administrative expenses and margins that would be incurred in the handling of these claims.

The Pool recorded additional reserves of \$154,326 for unallocated loss adjustment expenses (ULAE) and \$178,440 for reported losses.

ARIZONA PUBLIC EMPLOYERS HEALTH POOL

FINANCIAL STATEMENTS

ASSETS

	<u>As of June 30, 2012</u>			<u>As of</u>
	<u>Per</u>	<u>Examination</u>	<u>Per</u>	<u>June 30, 2011</u>
	<u>Pool</u>	<u>Differences</u>	<u>Examination</u>	<u>Per Pool</u>
<i>Assets:</i>				
Cash and cash equivalents	\$ 3,815,480	\$ 0	\$ 3,815,480	\$ 2,714,617
Investment securities	3,765,570		3,765,570	4,165,602
Contributions receivable	1,163,302		1,163,302	544,916
Reinsurance receivables	150,148		150,148	101,492
Interest and other receivables	30,896		30,896	29,944
Flex benefits paid in excess of contributions	3,186		3,186	3,175
Prepaid expenses	20,047		20,047	2,328
Restricted asset - cash and cash equivalents	10,580		10,580	7,182
<i>Totals</i>	<u>\$ 8,959,209</u>	<u>\$ 0</u>	<u>\$ 8,959,209</u>	<u>\$ 7,569,256</u>

Note: Financial statement exhibits may not reconcile due to rounding.

ARIZONA PUBLIC EMPLOYERS HEALTH POOL

LIABILITIES AND NET ASSETS

	As of June 30, 2012	As of June 30, 2011 Per Pool
<i>Liabilities:</i>		
Reserve for losses and loss expenses:		
Reported claims	\$ 178,440	\$ 157,663
Claims incurred but not reported	2,075,000	1,766,000
Unallocated loss adjustment expense	154,326	135,129
Unearned contributions	926,929	405,461
Unamortized capital contribution	0	200,000
Accounts payable and other accrued expenses	80,423	101,606
Flex savings accounts payable	13,765	10,357
<i>Total Liabilities</i>	3,428,883	2,776,216
<i>Net assets</i>		
Unrestricted net assets	5,530,326	4,793,040
<i>Total liabilities and net assets</i>	\$ 8,959,209	\$ 7,569,256

ARIZONA PUBLIC EMPLOYERS HEALTH POOL

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	For the Year Ending June 30, 2012			For the Year
	Per Pool	Examination Differences	Per Examination	Ending June 30, 2011 Per Pool
Revenues				
Contributions:				
Gross contributions	\$ 14,951,927	\$ 0	\$ 14,951,927	\$ 14,286,154
Cost of premiums and excess insurance	(851,400)		(851,400)	(751,025)
<i>Net contributions</i>	<u>14,100,527</u>	<u>0</u>	<u>14,100,527</u>	<u>13,535,129</u>
Interest and dividend income, net	141,206	0	141,206	137,322
Net increase in fair value on investments	45,810		45,810	10,871
<i>Net investment income</i>	<u>187,016</u>	<u>0</u>	<u>187,016</u>	<u>148,193</u>
<i>Total revenues</i>	<u>14,287,543</u>	<u>0</u>	<u>14,287,543</u>	<u>13,683,322</u>
Expenses				
Losses and loss expense	12,248,259	0	12,248,259	11,770,457
Claim service fees	822,383		822,383	864,880
Management fees	293,501		293,501	289,293
Administrative	176,159		176,159	207,002
Advertising	9,955		9,955	10,348
<i>Total expenses</i>	<u>13,550,257</u>	<u>0</u>	<u>13,550,257</u>	<u>13,141,980</u>
<i>Increase in net assets</i>	<u>737,286</u>	<u>0</u>	<u>737,286</u>	<u>541,342</u>
Net assets, beginning of year	4,793,040		4,793,040	4,251,698
<i>Net assets, end of year</i>	<u>\$ 5,530,326</u>	<u>\$ 0</u>	<u>\$ 5,530,326</u>	<u>\$ 4,793,040</u>

COMMENTS ON FINANCIAL STATEMENTS

The Pool prepares its financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), as set forth primarily in Financial Accounting Standards Board Statement No. 60, Accounting and Reporting by Insurance Enterprises and Governmental Accounting Standards Board Statements No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues and No. 30, Risk Financing Omnibus, and in conformity with the accounting practices prescribed or permitted by Arizona statutes.

The Financial Statements in this Report of Examination do not differ from the balances shown in the Pool's Audited Financial Report as of June 30, 2012.

The examination review of the Pool's financial statements resulted in the following notes and comments:

1. Claim Related Reserves

The Pool's financial statements provide an estimate for claims liabilities based on estimates of the ultimate cost of claims, including future allocated and unallocated claims adjustment expenses (ALAE and ULAE), that have been reported but not settled, and of claims that have been incurred but not reported (IBNR), gross of expected recovery from excess insurance carriers. The Pool's claim reserve estimates are reviewed annually by a consulting actuary and an actuarial opinion is rendered. Examination noted that the actuarial methodology was not based on individual claimants, but rather was based on the aggregate claim patterns with no adjustments made for large claimants. Thus, the reserve was calculated based on the gross paid losses.

2. Commitments and Other Contingencies

Excess Insurance Coverage: The Pool's financial statements report claim related reserves net of recoveries expected to be made under excess insurance contracts. In the event that the Pool's excess insurance carrier was unable or unwilling to meet their obligations under existing agreements, the Pool would be liable for such defaulted amounts. The Pool did not report any significant disputes with its excess insurance carrier.

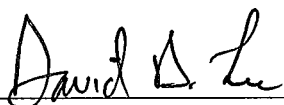
As of June 30, 2012, the Pool's excess insurance carrier was deemed to be financially sound and received a financial strength rating strength rating of AA- (Very Strong) from S&P and A+ (Superior) from A.M. Best.

3. **Federal Income Tax**

The Pool's membership is divided into two groups: Public Schools, Cities, Towns, Counties, Fire Districts and Sanitary Districts referred to as members, who have equity in the Pool, and Charter Schools referred to as participants, who do not have equity in the Pool. In order to determine if the contribution received from charter schools is subject federal income tax (FIT), the firm of CliftonLarsonAllen, CPA, LLP, Phoenix, Arizona, retained the service of two outside firms to research the Internal Revenue Service code applicable to charter schools. Based on the review performed by both firms, it is still unclear if the charter schools are subject to FIT. As of June 30, 2012, the Pool took the position that contribution from charter schools is exempt from FIT and no FIT liability was accrued for. The Pool's tax filing for 2012 included, in the disclosure statement, a reference to the tax code indicating that a charter schools are defined as a public school, which would make them exempt from FIT.

CONCLUSION

The preceding report of examination of the **Arizona Public Employers Health Pool**, as of June 30, 2012, reflects its financial condition in accordance with generally accepted accounting principles and Arizona Statutes. An Affidavit of the Examiner-in-Charge, Alan Noudali, CPA, is on file with the Arizona Department of Insurance and attests that the examination was performed based on guidance provided in the NAIC Financial Condition Examiners Handbook to assist in assessing and monitoring the current financial condition and prospective solvency of the Pool. Based on my review, to the best of my knowledge, the examination was performed in a manner consistent with that guidance and properly reflects the financial condition of the **Arizona Public Employers Health Pool**.



David B. Lee
Chief Financial Examiner
Financial Affairs Division
Department of Insurance
State of Arizona