

**COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND**

**ANNUAL REPORT
FOR THE FISCAL YEAR ENDED
JUNE 30, 2008**



RODNEY A. DOLE
SONOMA COUNTY
AUDITOR-CONTROLLER
TREASURER-TAX COLLECTOR

**COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND**

**Annual Report
For the Fiscal Year Ended
June 30, 2008**

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Auditor-Controller's Report

We have audited the accompanying basic financial statements of the business-type activities and the aggregate remaining fund information of the County of Sonoma Health Plan Internal Service Fund (Health Plan), as of and for the year ended June 30, 2008, which collectively comprise the basic financial statements as listed in the table of contents. These financial statements are the responsibility of the management of the County of Sonoma Human Resources Department and its Risk Management Division. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 I.A., the basic financial statements of the Health Plan 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 the aggregate remaining fund information of the County of Sonoma that is attributable to the transactions of the Health Plan. They do not purport to, and do not, present fairly the financial position of the County of Sonoma as of June 30, 2008, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note III.B., of the Notes to the Basic Financial Statements, the Auditor-Controller is mandated by various statutes within the California Government Code to perform certain accounting, auditing, and financial reporting functions. These activities, in themselves, necessarily impair the auditor's independence. However, we believe adequate safeguards and divisions of responsibility exist.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and the aggregate remaining fund information for the Health Plan as of June 30, 2008, and the respective changes in financial position and cash flows, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements, but is required supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Sonoma County Auditor-Controller

March 11, 2009

Management's Discussion and Analysis

As management of the County of Sonoma Health Plan (Health Plan), we offer readers of the Health Plan's financial statements this narrative overview and analysis of the financial activities of the Health Plan for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with the Health Plan's financial statements and the accompanying notes to the basic financial statements.

Financial Highlights

- The assets of the Health Plan exceeded liabilities at the close of the most recent fiscal year by \$16,363,017. Net assets increased by \$6,200,875 from the previous year. The increase in net assets can be attributed to decrease in employee participation in the healthcare plan, decrease in insurance claims expense and the increase in premiums charged.
- Total plan contributions amounted to \$31,461,048 during the fiscal year. This amount is a decrease of (2,745,247) (-8.0%) over the previous fiscal year. The decrease is attributed to the fewer plan participants than the previous year.
- Health Plan expenses during the fiscal year for payment of health care benefits was \$23,986,187, an increase of \$3,787,915 (19%). The increase is attributed to rising health care costs. Administrative expense during the fiscal year was \$1,901,502, an increase of \$59,408 (3%). The increase in administrative cost is attributed to consulting services for other postemployment benefits.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Health Plan's basic financial statements. The Health Plan's basic financial statements comprise two components: 1) basic financial statements; and 2) notes to the basic financial statements.

Basic financial statements - The Health Plan is an internal service fund of the County of Sonoma. Internal service funds exist to benefit government. In this case, to provide self-funded health care benefits to current and former employees of the County of Sonoma. Internal service funds use proprietary fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of an internal service fund is the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flow. The basic financial statements presented are the statement of net assets; the statement of revenues, expenses and change in net assets; and the statement of cash flows.

Notes to the basic financial statements - The notes provide additional information that is essential to a full understanding of the information provided in the basic financial statements.

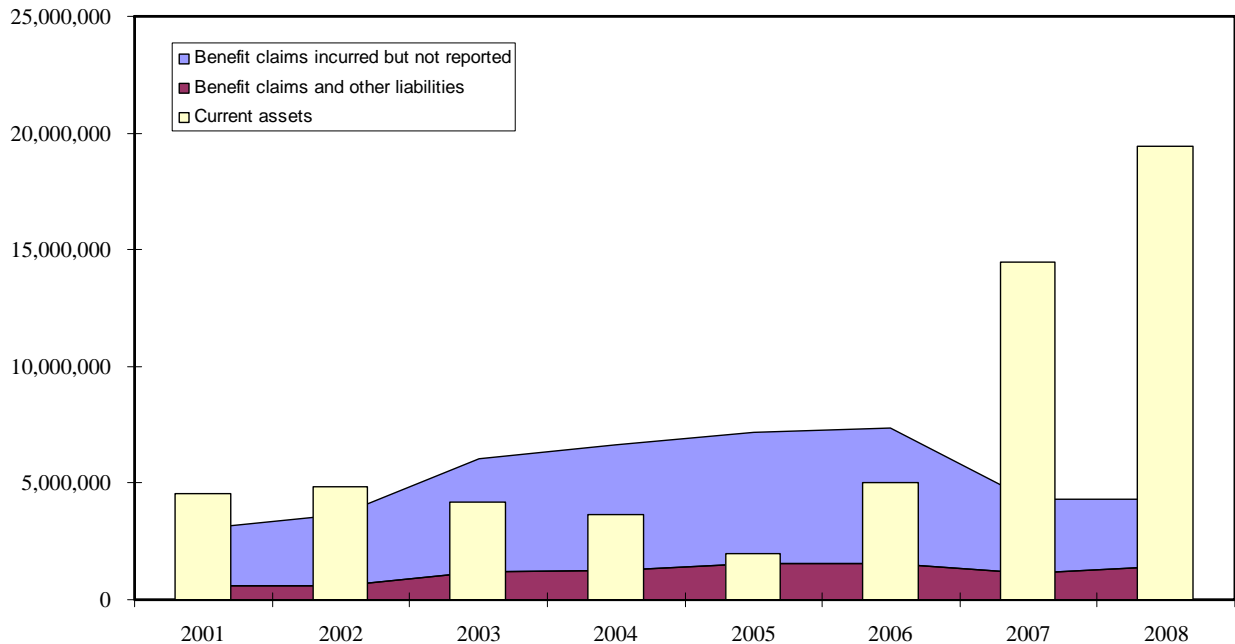
Financial Analysis

	Net Assets			Percentage Change
	2008	2007	Increase (Decrease)	
Current assets	\$ 20,652,279	\$ 14,493,527	\$ 6,158,752	42.5%
Current liabilities:				
Benefit claims and other liabilities	1,431,262	1,130,385	300,877	26.6%
Benefit claims incurred but not reported	<u>2,858,000</u>	<u>3,201,000</u>	<u>(343,000)</u>	-10.7%
Total current liabilities	<u>4,289,262</u>	<u>4,331,385</u>	<u>(42,123)</u>	-1.0%
Net assets (deficit)	<u>\$ 16,363,017</u>	<u>\$ 10,162,142</u>	<u>\$ 6,200,875</u>	-61.0%

Health Plan liabilities decreased by \$42,123 (1%) during the current fiscal year. The decrease is attributable to a decrease in the estimate of health care costs incurred during the fiscal year for which claims are yet to be filed.

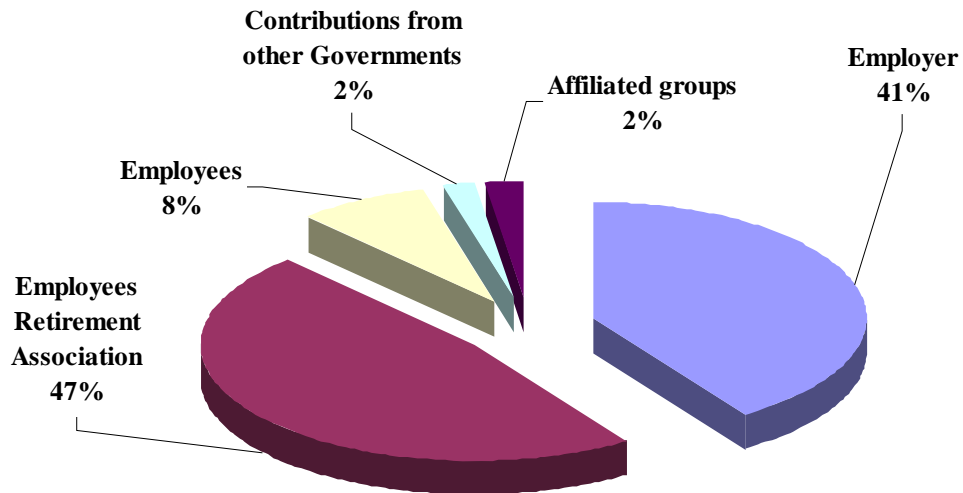
Net assets may serve over time as a useful indicator of a governmental unit's financial position. Health Plan assets exceed liabilities by \$16,363,017 at the close of the most recent fiscal year.

Historical Change in Net Assets



	Changes in Net Assets		Increase (Decrease)	Percentage Change
	2008	2007		
Revenues:				
Program revenues	\$ 31,461,048	\$ 34,206,295	\$ (2,745,247)	-8.0%
General revenues	627,516	331,683	295,833	89.2%
Total revenues	32,088,564	34,537,978	(2,449,414)	-7.1%
Operating expenses	25,887,689	22,040,366	3,847,323	17.5%
Changes in net assets	6,200,875	12,497,612	(6,296,737)	50.4%
Net assets (deficit), beginning of year	10,162,142	(2,335,470)	12,497,612	-535.1%
Net assets (deficit), end of year	\$ 16,363,017	\$ 10,162,142	\$ 6,200,875	-61.0%

Health Plan Contributions for 2008



Expenses are incurred primarily for the payment of health care claims (93%) and administrative expenses (7%).

Economic Factors and Next Year's Budget and Rates

Funding of the Health Plan is based on actuarially determined trends in claims payment with the intent of maintaining a year-end cash reserve equivalent to three months of anticipated claims costs. Total expenses budgeted for the fiscal year 2007/08 was \$36,418,040, with the anticipated net use of funds of \$2,039,426. The 2007/08 actual expenditures and revenues resulted in a 6,200,875 net increase in funds, due primarily to the significantly lower actual claims expense compared to budget.

For the fiscal year 2008/09 budgeted total expenses are \$35,918,484 a decrease of \$499,556. The fiscal year 2008/09 budgeted for an anticipated net use of funds of \$6,367,005.

Requests for Additional Information

This financial report is designed to provide a general overview of the County of Sonoma Health Plan's finances for all those with an interest in the Health Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Risk Manager, County of Sonoma Department of General Services, 575 Administrative Drive, Suite 116C, Santa Rosa, CA 95403.

COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Statement of Net Assets
June 30, 2008

Assets

Current assets:

Cash with fiscal agent/trustee	\$ 750,000
Cash and investments	18,153,118
Accounts receivable	549,161
Due from other governments	<u>1,200,000</u>
Total assets	<u>20,652,279</u>

Liabilities

Current liabilities:

Accounts payable	163,580
Benefit claims payable	1,267,682
Benefit claims incurred but not reported	<u>2,858,000</u>
Total liabilities	<u>4,289,262</u>

Net Assets

Net Assets	<u>16,363,017</u>
Total net assets	<u>\$ 16,363,017</u>

The notes to the basic financial statements are an integral part of this statement.

COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Statement of Revenues, Expenses, and Change in Fund Net Assets
For the Fiscal Year Ended June 30, 2008

Operating Revenues

Employer contributions	\$ 12,756,104
Employee contributions	2,444,870
Retirement plan contributions	14,921,770
Affiliated group contributions	738,304
Contributions from other governments	<u>600,000</u>
Total operating revenues	<u>31,461,048</u>

Operating Expenses

Health care benefits	23,986,187
Benefit manager fees	1,257,966
Administrative costs	<u>643,536</u>
Total operating expenses	<u>25,887,689</u>
Operating income	5,573,359

Non-operating Revenues

Investment earnings	<u>627,516</u>
Change in net assets	6,200,875
Total net assets (deficit), beginning of year	<u>10,162,142</u>
Total net assets, end of year	<u>\$ 16,363,017</u>

The notes to the basic financial statements are an integral part of this statement.

**COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008**

Cash Flows From Operating Activities

Receipts from general fund and other County funds	\$ 12,756,104
Receipts from employees	2,444,870
Receipts from Retirement plan	14,921,770
Receipts from Affiliated groups	738,304
Cash payments to health care providers	(24,572,674)
Cash payments to other suppliers of goods and services	(1,492,745)
Cash payments for interfund services used	(354,692)
	4,440,937
Net cash provided (used) by operating activities	4,440,937

Cash Flows From Investing Activities

Interest received	627,516
	627,516
Net increase in cash and cash equivalents	5,068,453
Cash and cash equivalents, beginning of year	13,834,665
	13,834,665
Cash and cash equivalents, end of year	\$ 18,903,118

(Continued)

The notes to the basic financial statements are an integral part of this statement.

**COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Statement of Cash Flows (continued)
For the Fiscal Year Ended June 30, 2008**

**Reconciliation of Operating Income to Net Cash
Provided (Used) by Operating Activities**

Operating income (loss)	\$ <u>5,573,359</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Change in assets and liabilities:	
(Increase) decrease in accounts and other receivables	(1,090,299)
Increase (decrease) in benefit claims and accounts payable	300,877
Increase (decrease) in benefit claims incurred but not reported	<u>(343,000)</u>
Total adjustments	<u>(1,132,422)</u>
Net cash provided (used) by operating activities	\$ <u><u>4,440,937</u></u>

**Reconciliation of Cash and Cash Equivalents
to the Statement of Net Assets**

Cash and investments	\$ 18,153,118
Cash with fiscal agent/trustee	<u>750,000</u>
Total cash and cash equivalents	\$ <u><u>18,903,118</u></u>

The notes to the basic financial statements are an integral part of this statement.

**COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Notes to the Basic Financial Statements
June 30, 2008**

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The County of Sonoma provides health care benefits to eligible employees. The County of Sonoma Health Plan (Health Plan) is self-insured by the County and is one of three options available to active employees and retirees. The schedule below, lists the number of active employees and retirees enrolled in the self-insured Health Plan.

As of June 30, 2008

	<u>County Health Plan</u>
Active employees	931
Retirees	<u>1,621</u>
Total	<u><u>2,552</u></u>

The County allows eligible members or beneficiaries receiving pension benefits to purchase post-retirement health insurance under the County sponsored health plan and this results in an implicit subsidy payable by the County. The Health Plan is an internal service fund of the County of Sonoma. The Health Plan is administered by the Risk Management Division of the Human Resources Department. The Health Plan accumulates assets from plan participants based on actuarial reports and pays active and postemployment health care benefits on a pay-as-you-go basis.

Employees are eligible if they are employed in a permanently allocated position in County service or with an affiliated group. The County's contribution to the Health Plan is paid out of current available resources and is funded on a pay-as-you-go basis. Employee contributions range from 14% to 16% depending on their applicable memorandum of understanding.

Retired employees are eligible if they meet the requirements of the County's defined benefit pension plan administered by the Sonoma County Employees' Retirement Association. The County contributes to a postemployment health care fund administered by SCERA. SCERA contributes amounts from the postemployment health care fund to the Health Plan based on rates authorized by the County Board of Supervisors. Retired employees contribute approximately 16% of the premium rates.

COUNTY OF SONOMA HEALTH PLAN
INTERNAL SERVICE FUND
Notes to the Basic Financial Statements
June 30, 2008

B. Measurement Focus, Basis of Accounting and Basis of Presentation

The Health Plan conforms to generally accepted accounting principles as applicable to governmental units. The accounts of the County of Sonoma are organized and operated on the basis of funds and account groups. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance related legal and contractual provisions.

Internal service funds account for operations that provide services to other departments or agencies of the government, or to other governments, on a cost-reimbursement basis. Such funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liability is incurred regardless of the timing of the related cash flows. Internal service funds distinguish operating revenues and expenses from non-operating items. Principal operating revenues consist of charges to the general fund of the County of Sonoma, the Sonoma County Employee Retirement Association, affiliated local governmental agencies and participating current and former employees. Operating expenses include the cost of services and administrative expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The Health Plan has elected under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board or any Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes Generally Accepted Accounting Principles (GAAP) for governmental units.

C. Assets, Liabilities, and Net Assets

1. Cash and investments

The Health Plan reports certain investments at fair value in the balance sheet and recognizes the corresponding change in the fair value of investments in the year in which the change occurred. The accompanying financial statements include a statement of cash flows. For this purpose, the Health Plan considers all pooled cash

COUNTY OF SONOMA HEALTH PLAN
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June 30, 2008

and investments as cash and cash equivalents because the County Treasurer's investment pool is used as a demand deposit account. Cash with trustee with a maturity of three months or less is also treated as cash and cash equivalents.

2. Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

II. DETAIL NOTES

A. Cash and Investments

1. Investments in the County Treasurer's Pooled Cash

The Health Plans' cash is pooled with the Sonoma County Treasurer, who acts as a disbursing agent for the Health Plan. The fair value of the Health Plan's investment in this pool is reported in the accompanying financial statements at amounts based upon the Health Plan's pro-rata share of the fair value provided by the Treasury Pool for the entire Treasury Pool portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on accounting records maintained by the Treasury Pool, which are recorded on an amortized cost basis. Interest earned on investments pooled with the County is allocated quarterly to the appropriate fund based on its respective average daily balance for that quarter. The Treasury Oversight Committee has regulatory oversight for all monies deposited into the Treasury Pool.

Investment Guidelines

The Health Plan's pooled cash and investments are invested pursuant to investment policy guidelines established by the County Treasurer and approved by the Board of Supervisors. The objectives of the policy are, in order of priority: safety of capital, liquidity and maximum rate of return. The policy addresses the soundness of financial institutions in which the County will deposit funds, types of investment instruments as permitted by the California Government Code 53601, and the percentage of the portfolio that may be invested in certain instruments with longer terms to maturity.

COUNTY OF SONOMA HEALTH PLAN
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A copy of the Treasury Pool investment policy is available upon request from the Sonoma County Auditor-Controller-Treasurer-Tax Collector at 585 Fiscal Drive, Room 100-F, Santa Rosa, California, 95403-2871.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. As a means of limiting its exposure to fair value losses arising from rising interest rates, one of the ways that the Treasury Pool manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturing evenly over time as necessary to provide the cash flow and liquidity needed for operations.

As of June 30, 2008, approximately 63 percent of the securities in the Treasury Pool had maturities of one year or less. Of the remainder, only 4 percent had a maturity of more than five years.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The Treasury Pool does not have a rating provided by a nationally recognized statistical rating organization.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Treasury Pool's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits and securities lending transactions:

**COUNTY OF SONOMA HEALTH PLAN
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- The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by depository regulated under stated law. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies.
- The California Government Code limits the total of all securities lending transactions to 20% of the fair value of the investment portfolio.

With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as the Treasury Pool).

Concentration of Credit Risk

The investment policy of the County contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. For a listing of investments in any one issuer (other than U.S. Treasury securities, mutual funds, or external investment pools) that represent 5 % or more of total County investments, refer to the 2008 Sonoma County CAFR.

2. Cash with fiscal agent/trustee

Cash with fiscal agent is used by the Health Plan's third party administrator to pay medical claims, and is collateralized by securities held by the financial institutions acting as fiscal agent. The funds are available for their designated purpose on short notice and are treated as a cash equivalent.

B. Receivables

1. Accounts receivable

Accounts receivable represents amounts due from affiliated groups for employer and employee contributions to the Health Plan and amounts due from the Health Plan excess limits insurance carrier for approved stop loss reimbursements.

2. Due from other governments

Due from other governments consists of amounts due from the Federal Government for Medicare Part D subsidy. Revenue related to Medicare Part D reimbursements is accrued when all eligibility requirements have been met. It can

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take up to two years for the Federal Government to process a request for Medicare Part D reimbursement.

C. Current Liabilities

1. Accounts payable

Accounts payable represents amounts due for services and supplies that have been received, but which are unpaid at the end of the fiscal year.

2. Claims payable

Claims payable represents claims approved for payment, which are unpaid at the end of the fiscal year.

3. Claims incurred but not reported

Claims incurred but not reported represent the liability for current unfiled claims and those claims that have been filed but not approved for payment. The amount is an actuarially calculated estimate of the plan liability at year-end. Each participating employer is required to disclose additional information with regard to funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

D. Contributions

Employers contributed \$12,756,104 on behalf of active and \$12,556,505 on behalf of retired employees, for County Health Plan insurance. Active and retired employees contributed \$2,444,870 and \$2,365,265 respectively, for County Health Plan insurance.

E. Health care benefits

Statement number 43 of the Governmental Accounting Standards Board requires separate reporting for the portion of plans that include both other postemployment benefits (OPEB) and benefits, such as healthcare benefits, that employees may take while in active service. Health care benefit expenses for active and retired employees were approximately \$10,553,922 and 13,432,265 respectively.

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III. OTHER INFORMATION

A. Risk Management

The County of Sonoma is self-insured as follows: \$300,000 per occurrence for workers' compensation claims, \$1,000,000 per occurrence for automobile and general liability claims, \$500,000 per occurrence and any amount in excess of \$10,000,000 per occurrence for hospital malpractice claims occurring prior to March 26, 1996, and \$275,000 per occurrence for health insurance claims with a stop loss coverage up to \$1,000,000 per claim. The County is entirely self-insured for unemployment claims and for long-term disability occurring prior to August 1, 1999.

The County participates in the CSAC Excess Insurance Authority excess liability insurance program. The County is covered under this program for \$1,000,000 to \$15,000,000 per occurrence for liability claims. Amounts in excess of \$300,000 per occurrence for worker's compensation claims within statutory limits are maintained through participation in the CSAC Excess Insurance Authority-Excess Workers' Compensation Program.

The County maintains "All Risk" coverage for physical loss and damage including flood and earthquake coverage through participation in the CSAC Excess Insurance Authority with the following limits and deductibles: \$400,000,000 limit per occurrence and \$50,000 deductible for "All Risk" and flood, earthquake deductible at \$500,000 per occurrence. Boiler and machinery coverage is included in the All-Risk coverage.

The County pays an annual basic premium for excess coverage and is assessed an annual risk premium based on an actuarial review that estimates each of the program's participant's ultimate liabilities. Settled claims have not exceeded the commercial coverage in any of the past three fiscal years.

B. Auditor Independence

As required by various statutes within the California Government Code, County Auditor-Controllers are mandated to perform certain accounting, auditing and financial reporting functions. These activities, in themselves, necessarily impair the auditor's independence. Specifically, "Auditors should not audit their own work or provide non audit services in situations where the amounts or services involved are significant or material to the subject matter of the audit." Although the office of the Auditor-Controller is statutorily obligated to maintain accounts of departments, districts or funds that are contained within the County Treasury, we believe that adequate safeguards and divisions of

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responsibility exist. Therefore, we believe that subject to this qualification and disclosure, the reader can rely on the auditor's opinion contained in this report.