

**NORTHERN ORANGE COUNTY
SELF-FUNDED WORKERS'
COMPENSATION AGENCY**

ANNUAL FINANCIAL REPORT

JUNE 30, 2017 AND 2016

**NORTHERN ORANGE COUNTY SELF-FUNDED WORKERS' COMPENSATION AGENCY
(A Joint Powers Entity)**

COSTA MESA, CALIFORNIA

JUNE 30, 2017

BOARD OF DIRECTORS

<u>REPRESENTATIVE</u>	<u>MEMBER</u>	<u>OFFICE</u>
Eric Fano	Savanna School District	President
Kelvin Tsunozumi	Buena Park School District	Vice President
Lynn Simmons	Coastline Regional Occupational Program	Secretary/Treasurer
Tim McLellan	Cypress School District	Member
Kathleen Thomason	Greater Anaheim Special Education Local Plan Area	Member
Carol Argomaniz	La Habra City School District	Member
Patricia Meyer	Los Alamitos Unified School District	Member
Annette Cleveland	Magnolia School District	Member
Howard Burkett	North Orange County Regional Occupational Program	Member
Scott Martin	Centralia School District	Member
Cindy Fox	College and Career Advantage	Member
Tony Wold	Westminster School District	Member

**NORTHERN ORANGE COUNTY SELF-FUNDED
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JUNE 30, 2017 AND 2016**

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FINANCIAL SECTION



INDEPENDENT AUDITOR'S REPORT

Board of Directors
Northern Orange County Self-Funded Workers' Compensation Agency
Costa Mesa, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Northern Orange County Self-Funded Workers' Compensation Agency (the Agency) as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Northern Orange County Self-Funded Workers' Compensation Agency, as of June 30, 2017 and 2016, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 12, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2017, on our consideration of the Northern Orange County Self-Funded Workers' Compensation Agency'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Northern Orange County self-Funded Workers' Compensation Agency's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Northern Orange County Self-Funded Workers' Compensation Agency's internal control over financial reporting and compliance.

Varrinell, Trine, Day & Co., LLP

Rancho Cucamonga, California
September 27, 2017



Northern Orange County Self-Funded Workers' Compensation Agency

PRESIDENT

Eric Fano
Savanna School District
1330 South Knott Avenue
Anaheim, CA 92804
(714) 236-3809

VICE PRESIDENT

Tim McLellan
Cypress School District
9470 Moody Street
Cypress, CA 90630
(714) 220-6900

TREASURER

Lynn Simmons
Coastline R.O.P.
1001 Presidio Square
Costa Mesa, CA 92626
(714) 220-6941

MEMBER DISTRICTS:

Buena Park SD

Centralia SD

Coastline ROP

Cypress SD

GASELPA

La Habra City SD

Los Alamitos Unified SD

Magnolia SD

North Orange County ROP

Savanna SD

College and Career Advantage

Westminster SD

This discussion and analysis provides an overview of the financial condition of Northern Orange County Self-Funded Workers' Compensation Agency (NOCSFWCA) for the fiscal years ended June 30, 2016 and June 30, 2017. It discusses NOCSFWCA's financial operations and analyzes the significant financial changes from the prior year. Readers should review the independent financial audit in conjunction with this report to enhance their understanding of NOCSFWCA's financial performance.

Introduction and Background

NOCSFWCA is a public risk sharing pool established pursuant to a Joint Power Agreement effective July 1, 1977, for the purpose of self-funding workers' compensation. Participation in NOCSFWCA gives members the advantage of pooled member contributions, sharing of claim liability risk and purchase of insurance at a lower cost. NOCSFWCA's membership consists of 12 individual member districts, from the Northern Orange County area. A Full Board of Directors comprised of one representative from each member governs NOCSFWCA. Each member has one vote. The Board elects from its members, a President, Vice President, Secretary, and Treasurer.

NOCSFWCA is able to retain a degree of control over their rate structure adding to the stability and longevity of their program. NOCSFWCA operates on a fiscal/program year from July 1st through June 30th with each program year operating separately from every other program year. By tracking financial activity by program year, only the members participating in a given program year will receive rebates or assessments. Further, other items such as administrative expenses and investment revenue can be accurately allocated to the proper program year's pooled equity or deficit.

Since its inception, NOCSFWCA has been proactive in controlling its costs by developing a comprehensive risk management program and safety credit reimbursement plan. The purpose of the reimbursement plan is to provide a fund for each member to designate their portion of rebates and additional contributions. This fund is then utilized at the discretion of the members for reimbursement and implementation of various safety and loss control programs within their districts.

Accredited by the California Association of Joint Powers Authorities (CAJPA), NOCSFWCA has maintained a high level of performance, member satisfaction, and fiscal stewardship among organizations of its kind.



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**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2017 AND 2016**

Mission Statement

"The mission of Northern Orange County Self-Funded Workers' Compensation Agency is to protect the members financial resources exposed to workers' compensation losses. Through its collective resources the authority will provide risk management and loss control services to assist in the reduction of claims with the goal of providing a safe work environment."

Program Structure

NOCSFWCA participated in SAWCX II from 1988-1989 to 1994-1995 for its excess coverage in the self-insured program years. As a member of SAWCX II, they paid an annual member contribution based upon their Self-Insured Retention (SIR) and shared in all rebates or deficits proportionate to their participation. On a biannual basis SAWCX II performs an actuarial review to analyze estimated ultimate incurred loss costs. Based upon increases in actuarial estimates, the Board of Directors has taken action to assess the current and former members of SAWCX II for deficit program years.

On July 1, 1995, NOCSFWCA took advantage of the insurance market and the lower rate structure by selecting a fully insured program that existed until June 30, 2003. In program year 2003-2004, NOCSFWCA joined as a member of the Protected Insurance Program for Schools (PIPS) under a Finite Risk Sharing program that utilizes reinsurance and continued as a member through 2016-2017.

Financial Management and Control

NOCSFWCA is responsible for establishing and maintaining an internal control structure designed to ensure that assets are protected from loss, theft, or misuse and to ensure that adequate accounting data are compiled to allow for preparation of financial statements in conformity with generally accepted accounting principles (GAAP).

NOCSFWCA has contracted with Keenan & Associates for administrative management responsibilities. These services include ensuring that NOCSFWCA meets its commitment to the members for operational efficiency, organizational integrity and for implementing policies established by the Board of Directors as set forth in organizational documents and bylaws. Service Enhancement Technologies (SETECH), a Division of Keenan & Associates, provides financial management and financial reporting to the Board. Budgetary control is provided by verification of budgeted amounts before expenses and the continued analysis of all account totals compared to budgeted amounts. Detailed financial statements and Treasurer's Reports include budget-to-actual comparisons and are provided to the NOCSFWCA Board on a quarterly basis. A comprehensive financial management information report is provided semi-annually and is the basis for the independent financial audit.

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NOCSFWCA has also contracted with Bay Actuarial Consultants to provide an independent actuarial review of the overall program. This study confirms the adequacy and reasonableness of the liabilities recorded as outstanding claim reserves for all program years. Finally, Vavrinek, Trine, Day & Co., LLP, Certified Public Accountants, has performed an independent audit examination of the financial statements in accordance with generally accepted auditing standards.

Basic Financial Statements

NOCSFWCA's financial statements are prepared in conformity with generally accepted accounting principles and necessarily include amounts based upon reliable estimates and judgments. The financial statements include the Statement of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, and Statement of Cash Flows.

The Statement of Net Position provides information on NOCSFWCA's program assets and liabilities, with the difference reported as Net Position. The Statement of Revenues, Expenses, and Changes in Net Position, presents information showing total operating revenue versus operating expenses for fiscal years 2015-2016 and 2016-2017 and the resulting effect on Net Position. The Statement of Cash Flows provides a reconciliation of the change during the fiscal year 2016-2017 in cash and cash equivalents.

NOCSFWCA calculates the financial position of each program year on the basis that each year stands on its own. Specifically, the funding determined necessary for each claim year is collected in that claim year, and all liabilities and expenses of each claim year are accounted for in the year they are incurred. At the close of each year, an evaluation of the Net Asset position of individual program years is conducted, and any funds remaining after taking into account outstanding liabilities and other obligations, are considered eligible for return to members in accordance with NOCSFWCA's Capital Target Policy revised on April 26, 2017, and reviewed annually. Over NOCSFWCA's 40 years of operation, it has declared and returned net member experience rebates of \$10,249,621.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2017 AND 2016**

FINANCIAL ANALYSIS

Condensed Statement of Net Position:

Below is a summary of the Statement of Net Position showing total assets versus total liabilities with a percentage of change from the 2015-2016 to the 2016-2017 program year.

	<u>As of June 30,</u>		<u>Difference</u>	<u>Percentage</u>
	<u>2017</u>	<u>2016</u>		
Current Assets				
Deposits and Investments	\$ 1,855,580	\$ 1,787,163	\$ 68,417	3.83 %
Other Assets	42,423	2,973	39,450	1,326.94
Total Assets	<u>1,898,003</u>	<u>1,790,136</u>	<u>107,867</u>	<u>6.03</u>
Current Liabilities				
Accounts Payable and Due to Members	1,214,989	1,134,268	80,721	7.12
Claim Liabilities and ULAE	21,000	50,000	(29,000)	(58.00)
Total Current Liabilities	<u>1,235,989</u>	<u>1,184,268</u>	<u>51,721</u>	<u>4.37</u>
Noncurrent Liabilities				
Claim Liabilities and ULAE	277,722	227,879	49,843	21.87
Total Liabilities	<u>1,513,711</u>	<u>1,412,147</u>	<u>101,564</u>	<u>7.19</u>
Net Position				
Undesignated	(107,266)	(119,000)	11,734	0.11
Designated - Capital Target	497,558	496,989	569	(9.86)
Total Net Position	<u>\$ 390,292</u>	<u>\$ 377,989</u>	<u>\$ 12,303</u>	<u>3.25 %</u>

**NORTHERN ORANGE COUNTY SELF-FUNDED
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**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2017 AND 2016**

Assets:

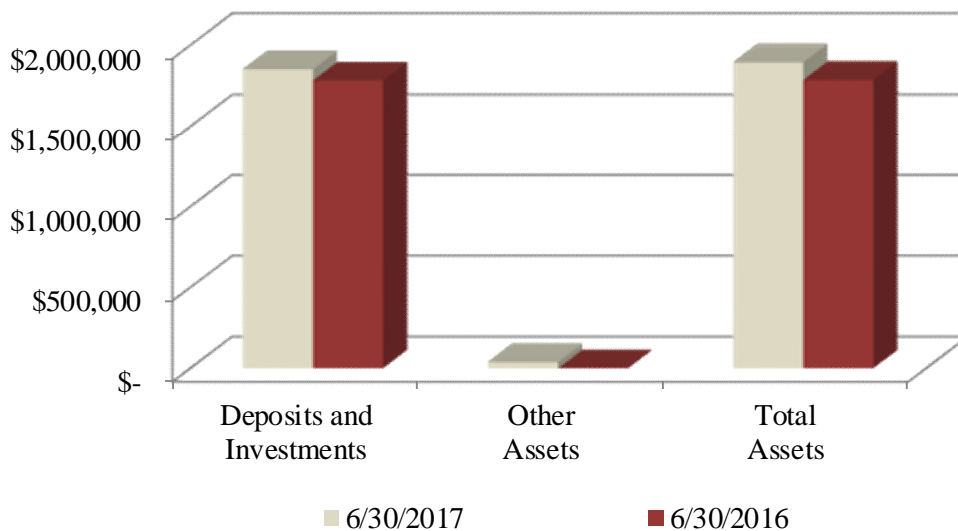
The overall assets of NOCSFWCA increased in 2016-2017 by \$107,867 or 6.03 percent, which is largely attributed to:

- Net contributions to the Safety Credit program of \$75,731
- Administrative expenditures below budget of \$ 24,773
- Investment income in the amount of \$12,788

Offset by:

- Claims paid in 2016-2017 for the self-insured program years of \$1,565

This increase in assets can be seen below:



The funds not necessary for the payment of claims are invested in the Orange County Treasury. Those assets needed for current operations are maintained with the State of California Local Agency Investment Fund (L.A.I.F.) and Union Bank general and claim checking accounts.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
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Liabilities:

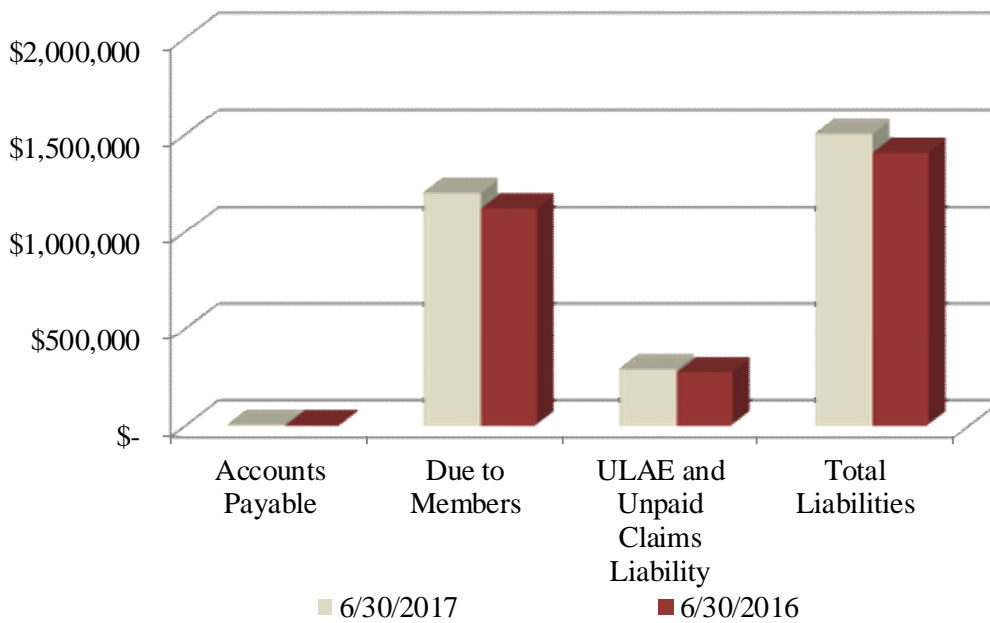
The overall liabilities of NOCSFWCA increased in 2016-2017 by \$95,564 or 6.77 percent, which is mainly attributed to:

- Net contributions to the Safety Credit program of \$75,731
- An increase in estimate ultimate incurred of \$16,873 for the self-insured program year 1994-1995 and prior, based on the actuary study dated April 2017

Offset by:

- Claims paid in 2016-2017 of \$1,565

This increase in liabilities can be seen below



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Fund Net Position:

NOCSFWCA's Net Position of \$390,292 is below the capital target, and reflects an actuarially-determined greater than 90 percent probability level funding of its outstanding liabilities. A 90 percent probability level funding means that there is only a 10 percent probability that the outstanding liability is higher or lower than the actuary's best estimate. Most actuarial funding recommendations are at the 70 percent probability level, therefore, NOCSFWCA's financial position provides an increased probability of overall reserve adequacy. Probability level funding recommendations based upon the Bay Actuarial Consultants actuarial study dated April 2017 are:

- 80% probability level \$130,202
- 90% probability level \$347,558

In order to prevent premature release of the Net Position, NOCSFWCA has adopted a capital target policy that is reviewed annually. The capital target is set at an actuarially determined contingency margin at 90 percent probability level plus an additional \$150,000 as approved at the April 27, 2017 Board of Directors meeting. Once the fund balance is calculated, the sum of those funds is reduced by the capital target/contingency margin and the balance is identified for return to members upon approval by the Board of Directors.

When rebates are declared by NOCSFWCA, the members have four choices for the use of the funds: 1) Credit next year's contribution, 2) Credit a Safety Credit Program, 3) Direct return to the member, and 4) Leave in NOCSFWCA in the member's name or in an interest bearing account.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
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Statement of Revenues, Expenses, and Changes in Net Position:

Expenses are less than revenues by \$12,303 in 2016-2017, resulting in a net increase to the Fund Net Position of 3.25 percent as shown in the Condensed Statement of Revenues/Expenses shown below.

	<u>As of June 30,</u>		<u>Difference</u>	<u>Percentage</u>
	<u>2017</u>	<u>2016</u>		
Operating Revenue:				
Contributions	\$ 6,077,553	\$ 5,885,482	\$ 192,071	3.26 %
Safety Credit Program	(24,776)	(13,854)	10,922	78.84
Total Operating Revenue	<u>6,052,777</u>	<u>5,871,628</u>	<u>181,149</u>	<u>3.09</u>
Operating Expenses:				
PIPS Premium	5,793,038	5,615,008	178,030	3.17
Claims Activity	16,408	10,921	5,487	50.24
Claims Administration	8,850	9,450	(600)	(6.35)
Risk Management Fee	19,033	15,700	3,333	21.23
Operating Costs	215,933	227,121	(11,188)	(4.93)
Total Operating Expenses	<u>6,053,262</u>	<u>5,878,200</u>	<u>175,062</u>	<u>2.98</u>
Non Operating Revenues				
Investment Income	<u>12,788</u>	<u>12,420</u>	<u>368</u>	<u>2.96</u>
Change in Net Position	12,303	5,848	6,455	110.38
Beginning Net Position	<u>377,989</u>	<u>372,141</u>	<u>5,848</u>	<u>1.57</u>
Ending Net Position	<u>\$ 390,292</u>	<u>\$ 377,989</u>	<u>\$ 12,303</u>	<u>3.25 %</u>

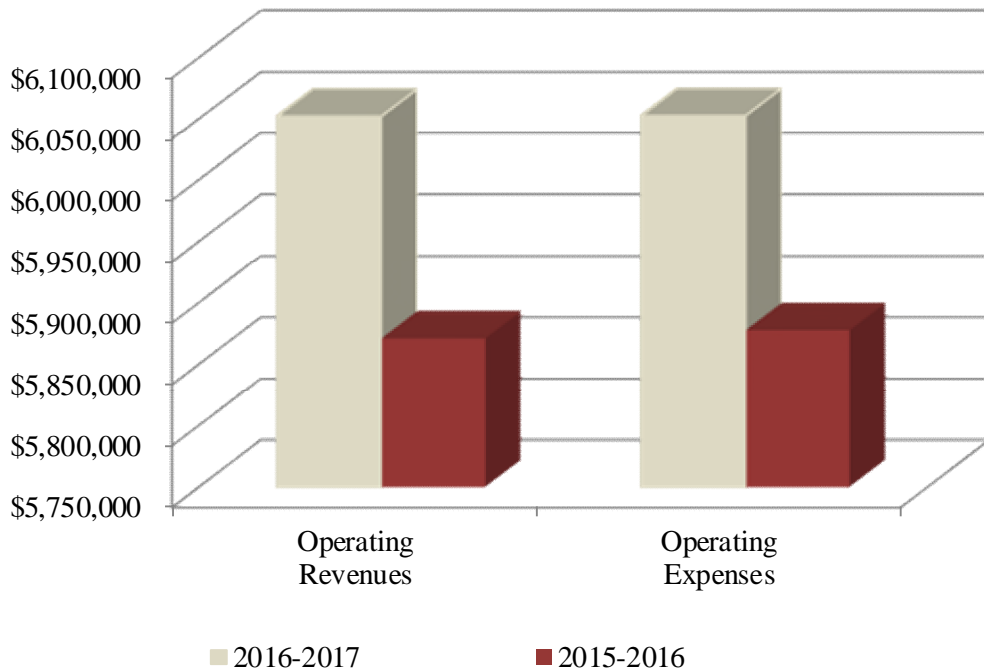
Operating revenue consists of contributions received from the members offset by excess insurance premiums. Premium contributions and excess insurance premiums increased by \$192,071 and \$178,030 respectively. Premium contributions increased due to an 8.84 percent increase in estimated payroll and a 1.63 percent decrease in the adopted rate.

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Total operating expenses increased by 2.98 percent in 2016-2017 from \$5,878,200 to \$6,053,262. The greatest cost increase is in the excess insurance premium of \$178,030, which is consistent with the increase in contributions, resulting from the 8.84 percent increase in payroll.

Below is a graph that reflects a comparison of operating income and expense for 2015-2016 and 2016-2017



Budgetary Highlights:

Each year the NOCSFWCA Board of Directors approves a budget and establishes rates and funding levels for the program year. The preliminary budget is reviewed by the Board in May, with a final budget to be approved by the Board in June. The final budget incorporates any changes in assumptions or projections that have been made subsequent to the approval of the preliminary budget. NOCSFWCA is not required to make mid-year budget adjustments.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2017 AND 2016**

Below is a summary of the budget information with a comparison to actual expenses. The largest difference between budgeted to actual numbers results from the prior year PIPS.

	<u>2016-2017</u>			
	<u>Adopted Budget</u>	<u>Actual</u>	<u>Difference</u>	<u>Percentage</u>
Operating Revenue				
Member Contributions	\$ 5,806,952	\$ 6,077,553	\$ 270,601	4.66 %
Safety Credit Program	(24,776)	(24,776)	-	-
Total Operating Revenues	<u>5,782,176</u>	<u>6,052,777</u>	<u>270,601</u>	<u>4.68</u>
Operating Expenses:				
Excess Insurance	5,522,437	5,793,038	270,601	4.90
Claims Activity	(8,850)	16,408	25,258	(285.40)
Claims Administration	8,850	8,850	-	-
Risk Management Fee	19,033	19,033	-	-
Operating Costs	240,706	215,933	(24,773)	(10.29)
Total Operating Expenses	<u>5,782,176</u>	<u>6,053,262</u>	<u>271,086</u>	<u>4.69</u>
Non Operating Income				
Investment Income	<u>5,306</u>	<u>12,788</u>	<u>7,482</u>	<u>141.01</u>
Change in Net Position	5,306	12,303	6,997	131.87
Beginning Net Position	377,989	377,989	-	-
Ending Net Position	<u>\$ 383,295</u>	<u>\$ 390,292</u>	<u>\$ 6,997</u>	<u>1.83 %</u>

Description of Facts or Conditions That are Expected to Have a Significant Effect on Financial Position or Results of Operations

From a California standpoint, the Workers' Compensation rates are beginning to stabilize at current levels primarily as a result of SB 863 passed in 2012 which appears to be stemming the pace of increase especially in the area of medical costs. For large Public Entities however, such as PIPS or other large JPAs, their program rates will also be largely based on their own experience.

**NORTHERN ORANGE COUNTY SELF-FUNDED
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**STATEMENTS OF NET POSITION
JUNE 30, 2017 AND 2016**

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets		
Deposits and investments	\$ 1,855,580	\$ 1,787,163
Prepaid expense	19,032	-
Receivables	23,391	2,973
Total Assets	<u>1,898,003</u>	<u>1,790,136</u>
 LIABILITIES		
Current Liabilities		
Accounts payable	8,587	7,006
Due to members	1,206,402	1,127,262
Current portion of unpaid claims and loss adjustment expenses	21,000	50,000
Total Current Liabilities	<u>1,235,989</u>	<u>1,184,268</u>
Unpaid claims and loss adjustment expenses, non-current portion	<u>271,722</u>	<u>227,879</u>
Total Liabilities	<u>1,507,711</u>	<u>1,412,147</u>
 NET POSITION - UNRESTRICTED	 <u>\$ 390,292</u>	 <u>\$ 377,989</u>

The accompanying notes are an integral part of these financial statements.

**NORTHERN ORANGE COUNTY SELF-FUNDED
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**STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**

	<u>2017</u>	<u>2016</u>
OPERATING INCOME		
Contributions	\$ 6,077,553	\$ 5,885,482
Safety credit program	(24,776)	(13,854)
Total Operating Income	<u>6,052,777</u>	<u>5,871,628</u>
OPERATING EXPENSES		
Excess insurance	5,793,038	5,615,008
Claims payments	1,565	12,585
Provision for loss reserves	15,924	3,591
Credit for ULAE	(1,081)	(5,255)
Claims administration	8,850	9,450
Administration expenses	23,761	19,904
JPA administration	90,750	90,750
Risk management	19,033	15,700
Contract services	27,320	32,229
DSIP assessment	74,102	84,238
Total Operating Expenses	<u>6,053,262</u>	<u>5,878,200</u>
Operating Loss	<u>(485)</u>	<u>(6,572)</u>
NON-OPERATING REVENUES		
Interest, net of interest allocated directly to members of \$9,415 in 2017 and \$6,395 in 2016	<u>12,788</u>	<u>12,420</u>
CHANGE IN NET POSITION	12,303	5,848
NET POSITION, BEGINNING OF YEAR	<u>377,989</u>	<u>372,141</u>
NET POSITION, END OF YEAR	<u>\$ 390,292</u>	<u>\$ 377,989</u>

The accompanying notes are an integral part of these financial statements.

**NORTHERN ORANGE COUNTY SELF-FUNDED
WORKERS' COMPENSATION AGENCY
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**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from members and others, net	\$ 6,131,917	\$ 5,583,707
Cash paid for claims and settlements	(19,821)	(8,112)
Cash paid for excess insurance	(5,793,038)	(5,615,008)
Cash paid to suppliers for goods and services	(261,872)	(236,648)
	<u>57,186</u>	<u>(276,061)</u>
Net Cash Provided by (Used in) Operating Activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income	<u>11,231</u>	<u>11,735</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	68,417	(264,326)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>1,787,163</u>	<u>2,051,489</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 1,855,580</u>	<u>\$ 1,787,163</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating loss	\$ (485)	\$ (6,572)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Changes in Assets and Liabilities:		
(Increase) decrease in accounts receivable	(18,861)	5,494
(Increase) decrease in prepaid expenses	(19,032)	15,700
Increase (decrease) in accounts payable	1,581	(1,098)
Increase (decrease) in amounts due members	79,140	(287,921)
Increase (decrease) in claims and unallocated expense liability	14,843	(1,664)
	<u>14,843</u>	<u>(1,664)</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 57,186</u>	<u>\$ (276,061)</u>

The accompanying notes are an integral part of these financial statements.

**NORTHERN ORANGE COUNTY SELF-FUNDED
WORKERS' COMPENSATION AGENCY
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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Northern Orange County Self-Funded Workers' Compensation Agency (the Agency) was formed and became operational on September 28, 1977, when the Cypress Elementary School District, Los Alamitos Unified School District, Magnolia Elementary School District, Savanna Elementary School District, and Westminster Elementary School District joined together under the California Government Code to create a public agency. The following local educational agencies became members of the Agency on the respective dates:

Centralia Elementary School District	10/14/77
La Habra Elementary School District	10/01/78
Buena Park Elementary School District	07/01/79
Greater Anaheim Special Education Local Plan Area (GASELPA)	11/01/85
Coastline Regional Occupational Program	07/01/87
North Orange County Regional Occupational Program	10/01/87
College and Career Advantage (Formerly - South Coast Regional Occupations Program)	07/01/96

The purpose of the Agency is to provide its members the necessary workers' compensation coverage as presented by the laws of the State of California.

The Agency functions as a pool for its respective members. Each member of the Agency is liable only for its prorata share, based on all premiums paid, of all debts and liabilities of the Agency.

The Agency includes all funds and account groups that are controlled by or dependent on the Agency's governing board for financial reporting purposes. The Agency has considered all potential component units in determining how to define the reporting entity, using criteria set forth in accounting principles generally accepted in the United States of America. The Agency determined that there are no potential component units that meet the criteria for inclusion within the reporting entity.

**NORTHERN ORANGE COUNTY SELF-FUNDED
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(A Joint Powers Entity)**

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

B. Basis of Accounting

The accompanying financial statements are presented as a proprietary fund on the accrual basis of accounting in accordance with governmental Generally Accepted Accounting Principles (GAAP). Under the accrual basis, revenues and the related assets are recognized when earned, and expenses and related liabilities are recognized when the obligation is incurred. Operating revenues include member contributions net of any applicable rate credits. Operating expenses include the provision for claims and claims adjustment expenses, insurance premiums, premium rebates, and general and administrative expenses. All other revenues and expenses are considered non-operating.

Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Agency has elected to apply all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Agency has elected not to apply FASB pronouncements issued after November 30, 1989, when preparing the financial statements.

C. Budgets and Budgetary Accounting

Annually, the Board of Directors adopts a budget that is subject to amendment throughout the year to give consideration to unanticipated revenue and expenses primarily resulting from events unknown at the time of budget adoption.

D. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

E. Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with original maturities of three months or less. For purposes of the Statement of Cash Flows, deposits with the County Treasury and the State Investment Pool Local Agency Investment Fund (LAIF) are considered to be cash equivalents.

F. Prepaid Expenses

Prepaid expenses represent amounts paid in advance of receiving goods or services.

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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

G. Claims Liabilities

The Agency establishes claims liabilities based on estimates of the ultimate cost of claims (including future claims administrative costs) that have been reported but not settled, and of claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts of salvage and subrogation and excess insurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are computed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

H. Member Contributions

Each member's contribution is determined based upon the number of plan participants and the contribution rate for each classification of covered participant. The rates for each member are determined based on each member's loss history, unusual exposures, and other pertinent information. If the total obligations would exceed the total assets of the Agency, the members may be assessed additional contributions.

I. Excess Insurance

The Agency uses excess insurance agreements to reduce its exposure to large losses. Excess insurance permits recovery of a portion of losses from excess insurance carriers, although it does not discharge the primary liability of the Agency as direct insurer of the risks insured. The Agency does not report excess insurance risks as liabilities unless it is probable that those risks will not be covered by excess insurance carriers.

J. Income Taxes

The Agency's income is exempt from Federal and State income taxes under Internal Revenue Code Section 115, and the corresponding section of the California Revenue and Taxation Code.

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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

NOTE 2 - CASH AND INVESTMENTS

A. Summary of Cash and Investments

Cash and investments as of June 30, 2017 and 2016, consist of the following:

	<u>2017</u>	<u>2016</u>
Cash on hand and in banks	\$ 655	\$ 4,875
Cash in trust account	100,000	100,000
Investments in County Treasury	1,421,944	1,410,875
Investments in State Investment Pool	332,981	271,413
Total Cash and Cash Equivalents	<u>\$ 1,855,580</u>	<u>\$ 1,787,163</u>

B. Policies and Practices

The Agency is authorized under California Government Code to make direct investments in local agency bonds, notes, or warrants within the State; U.S. Treasury instruments; registered State warrants or treasury notes; securities of the U.S. Government, or its agencies; bankers acceptances; commercial paper; certificates of deposit placed with commercial banks and/or savings and loan companies; repurchase or reverse repurchase agreements; medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations.

C. Investment in County Treasury

The Agency is considered to be an involuntary participant in an external investment pool as the Agency is required to deposit all receipts and collections of monies with their County Treasurer (*Education Code Section 41001*). The fair value of the Agency's investment in the pool is reported in the accounting financial statements at amounts based upon the Agency's pro-rata share of the fair value provided by the County Treasurer for the entire portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by the County Treasurer, which is recorded on the amortized cost basis.

D. Investment in the State Investment Pool

The Agency is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California *Government Code* Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the Agency's investment in the pool is reported in the accompanying financial statement at amounts based upon the Agency's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on the amortized cost basis.

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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

E. Custodial Credit Risk - Deposits

This is the risk that in the event of a bank failure, the Agency's deposits may not be returned to it. The Agency does not have a policy for custodial credit risk for deposits. However, 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 a depository regulated under State law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agencies. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. As of June 30, 2017 and 2016, the Agency's bank balances were not exposed to custodial credit risk.

NOTE 3 - FAIR VALUE MEASUREMENTS

The Agency categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value. The following provides a summary of the hierarchy used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets that the Agency has the ability to access at the measurement date. Level 1 assets may include debt and equity securities that are traded in an active exchange market and that are highly liquid and are actively traded in over-the-counter markets.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable, such as interest rates and curves observable at commonly quoted intervals, implied volatilities, and credit spreads. For financial reporting purposes, if an asset has a specified term, a Level 2 input is required to be observable for substantially the full term of the asset.

Level 3 - Unobservable inputs should be developed using the best information available under the circumstances, which might include the Agency's own data. The Agency should adjust that data if reasonably available information indicates that other market participants would use different data or certain circumstances specific to the Agency are not available to other market participants.

Uncategorized - Investments in the State Investment Pool Local Agency Investment Fund and Country Treasury are not measured using the input levels above because the Agency's transactions are based on a stable net asset value per share. All contributions and redemptions are transacted at \$1.00 net asset value per share.

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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

NOTE 4 - RECEIVABLES

Receivables at June 30, 2017 and 2016, consist of the following:

	<u>2017</u>	<u>2016</u>
Reinsurance receivable	\$ 19,839	\$ 978
Interest income	3,552	1,995
Total Accounts Receivable	<u>\$ 23,391</u>	<u>\$ 2,973</u>

NOTE 5 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2017 and 2016, consist of the following:

	<u>2017</u>	<u>2016</u>
Accounts payable	\$ 7,476	\$ 6,500
Claims payable	1,111	506
Total Accounts Payable	<u>\$ 8,587</u>	<u>\$ 7,006</u>

NOTE 6 - DUE TO MEMBERS

The amounts due to members at June 30, 2017 and 2016, are summarized below:

	<u>2017</u>	<u>2016</u>
Buena Park School District	\$ 119,658	\$ 118,701
Centralia School District	408,314	405,110
Coastline Regional Occupational Program	28,950	28,220
Cypress School District	109,109	108,235
Greater Anaheim Special Education Local Plan Area (GASELPA)	10,331	8,761
La Habra City School District	35,282	32,922
Los Alamitos Unified School District	154,459	155,840
Magnolia School District	92,290	83,741
North Orange County Regional Occupational Program	150,421	101,929
Savanna Elementary	23,386	20,493
Westminster School District	74,202	63,310
Total	<u>\$ 1,206,402</u>	<u>\$ 1,127,262</u>

**NORTHERN ORANGE COUNTY SELF-FUNDED
WORKERS' COMPENSATION AGENCY
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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

NOTE 7 - UNPAID CLAIMS LIABILITIES

As discussed in Note 1, the Agency establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities for the Agency during the years ended June 30, 2017 and 2016:

	June 30,	
	2017	2016
Claims liabilities at beginning of fiscal year	\$ 259,598	\$ 256,007
Incurred expenses related to:		
Insured events of prior fiscal years	17,489	16,176
Payments related to:		
Insured events of prior fiscal years	1,565	12,585
Claims liabilities at end of fiscal year	<u>\$ 275,522</u>	<u>\$ 259,598</u>

The component units of the unpaid claims and claim adjustment expenses as of June 30, 2017 and 2016, were as follows:

	2017	2016
Claims liability	\$ 275,522	\$ 259,598
Unallocated loss adjustment expenses	17,200	18,281
	<u>292,722</u>	<u>277,879</u>
Current portion	(21,000)	(50,000)
	<u>\$ 271,722</u>	<u>\$ 227,879</u>

NOTE 8 - NET POSITION

Net position is composed of the following elements as of June 30, 2017 and 2016:

	2017	2016
Unrestricted		
Designated - Capital target	\$ 497,558	\$ 496,989
Undesignated	(107,266)	(119,000)
Total Net Position	<u>\$ 390,292</u>	<u>\$ 377,989</u>

**NORTHERN ORANGE COUNTY SELF-FUNDED
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**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016**

NOTE 9 - PARTICIPATION IN PUBLIC ENTITY RISK POOLS

The Agency participates in two joint ventures under joint powers agreements (JPA's) as described below. The relationship between the Agency and the JPAs is that the JPAs are not component units of the Agency for financial reporting purposes.

Schools Alliance for Workers' Compensation Excess Self-Funded (SAWCX II)

SAWCX II arranges for and provides for the joint group purchase of workers' compensation excess protection for its members. SAWCX II is governed by a board consisting of a representative from each member. The board controls the operations of SAWCX II, including approval of an operating budget. Each member pays a premium commensurate with the level of coverage requested and shares surpluses and deficits proportionate to their participation in SAWCX II.

No payments were made to SAWCX II during the 2016-2017 program years.

The Protected Insurance Program for Schools and Community Colleges Joint Powers Authority (PIPS)

The PIPS arranges for and provides for the joint group purchase of workers' compensation reinsurance for its members. The PIPS is governed by an executive board consisting of nine members, five are K-12, and four are community colleges. This board controls the operations of the PIPS including approval of an operating budget. Each member pays a premium commensurate with their experience modification within the pool and shares surpluses and deficits proportionate to their participation in PIPS.

Payments for the current year \$ 5,793,038

INDEPENDENT AUDITOR'S REPORTS



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Directors
Northern Orange County Self-Funded Workers' Compensation Agency
Torrance, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Northern Orange County Self-Funded Workers' Compensation Agency (the Agency) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Northern Orange County Self-Funded Workers' Compensation Agency's basic financial statements, and have issued our report thereon dated September 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Northern Orange County Self-Funded Workers' Compensation Agency's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Northern Orange County Self-Funded Workers' Compensation Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of Northern Orange County Self-Funded Workers' Compensation Agency's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Agency's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

Purpose of This Report

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

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
September 27, 2017

SCHEDULE OF FINDINGS

**NORTHERN ORANGE COUNTY SELF-FUNDED
WORKERS' COMPENSATION AGENCY
(A Joint Powers Entity)**

**SCHEDULE OF FINANCIAL STATEMENT FINDINGS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**

There were no findings related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

**NORTHERN ORANGE COUNTY SELF-FUNDED
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**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**

There were no audit findings reported in the prior year's schedule of financial statement findings.