

**MONTEREY BAY AREA
SELF INSURANCE AUTHORITY**

FINANCIAL STATEMENTS

FOR THE YEARS ENDED
JUNE 30, 2008 AND 2007

AND INDEPENDENT
AUDITORS' REPORT

MONTEREY BAY AREA SELF INSURANCE AUTHORITY

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INDEPENDENT AUDITORS' REPORT

**Board of Directors
Monterey Bay Area Self Insurance Authority
Santa Cruz, California**

We have audited the accompanying financial statements of the enterprise fund, each major fund, and the aggregate remaining fund information of *Monterey Bay Area Self Insurance Authority* as of and for the years then ended, June 30, 2008 and 2007, which collectively comprise the Authority's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion 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, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and State Controller's Minimum Audit Requirements for California Special Districts. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects, the respective financial position of the enterprise fund activities, each major fund, and the aggregate remaining fund information of the Authority at June 30, 2008 and 2007, and the respective changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 16, 2009, on our consideration of *Monterey Bay Area Self Insurance Authority's* internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The accompanying Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. *Monterey Bay Area Self Insurance Authority's* presentation of Ten-Year Claims Development Information on pages 26 through 29, which the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements, does not include estimates for incurred but not reported (IBNR) claims prior to July 1, 2003.

Our audits were made for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements of *Monterey Bay Area Self Insurance Authority*. The accompanying statements of revenues and expenses – budget and actual are presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

January 16, 2009

Hayashi Iwasaki

MONTEREY BAY AREA SELF INSURANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

This section of *Monterey Bay Area Self Insurance Authority's* annual financial report presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2008 and 2007. Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Authority's basic financial statements. Comparisons to and analysis of the prior year are incorporated where appropriate.

FINANCIAL HIGHLIGHTS

- The Authority's net assets increased (decreased) by \$(1,526,798) (or (29%)) during 2008, \$723,033 (or 12%) during 2007 and \$2,616,234 (or 31%) during 2006. Since the Authority engages only in business-type activities, the increase is all in the category of business-type net assets. Net Assets were \$(6,830,367), \$(5,303,569) and \$(6,026,602) for 2008, 2007 and 2006 respectively.
- Total cost of all of the Authority's programs were \$6,183,313 in 2008, \$3,778,871 in 2007 and \$2,081,720 in 2006.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Authority has chosen to present its financial statements using the reporting model for special-purpose governments engaged in only business-type activities. This model allows all financial information for the organization to be reported in a single column in each of the financial statements. The effect of internal activity between funds and groups of funds has been eliminated from these financial statements.

The financial statements include Statements of Net Assets, Statements of Revenues, Expenses and Changes in Net Assets, Statements of Cash Flows, Combining Statements of Net Assets, Combining Statements of Revenues, Expenses and Changes in Net Assets, Combining Statements of Cash Flows, notes to the financial statements, an Independent Auditors' Report thereon and this Management's Discussion and Analysis. Readers of these financial statements are encouraged to consider the report as a whole to obtain a complete understanding of the Authority's financial condition.

Statements of Net Assets

The Statements of Net Assets is a report of the Authority's assets, liabilities and net assets. Assets and liabilities are reported at book value, on an accrual basis as of the statement date. Assets and liabilities have been segregated between Current (expected to be liquidated or paid within one year) and Noncurrent. Net assets are reported in major categories reflecting any restriction thereon.

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

Statements of Revenues, Expenses and Changes in Net Assets

The Statements of Revenues, Expenses and Changes in Net Assets presents the Authority's revenue earned and expense incurred during the period on an accrual basis. The Statements have been segregated into operating and nonoperating sections.

Statements of Cash Flows

The Statements of Cash Flows presents the source and uses of cash and is segregated into operating, capital and related financing, noncapital financing and investing activities. The direct method of cash flows reporting has been used and an indirect method of calculating cash provided (used) by operations is also presented.

Fund Financial Statements

The fund financial statements provide more detailed information about the Authority's most significant funds. The Fund consists exclusively of Enterprise Funds, but the focus now is on Major Funds, rather than fund types. In order to be selected as major fund, the fund's assets, liabilities, revenues, or expenses should be at least 10% or more of the fund type's total assets, liabilities, revenues or expenses and at least 5% or more of the Authority's total assets, liabilities, revenues or expenses. Since the Authority has only one fund type, 10% criteria is used to determine major funds. The Enterprise method of accounting is similar to accounting utilized by the private sector.

FUNDS

Business Type Funds

Workers' Compensation Fund – Under the Workers' Compensation Fund, the Authority provides workers' compensation insurance to member municipalities. The principal operating revenue for the Workers' Compensation Fund is premiums collected from the members. Operating expenses for this fund include claims expense, contract risk management services expense, and administrative expenses.

Liability Fund – Under the Liability Fund, the Authority provides liability insurance to member municipalities. The principal operating revenue for the Liability Fund is premiums collected from the members. Operating expenses for this fund include claims expense, contract risk management services expense, administrative expenses and insurance expense for excess of loss coverage.

Other Non-major Funds – In addition to the major funds above, the Authority also maintains the following non-major funds:

E. A. P. Fund
Property Insurance Fund

COMPARATIVE ANALYSIS

Statements of Net Assets

A comparative summary of the Authority's Statements of Net Assets at June 30 which generally reflects its financial condition, is as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current assets	\$ 14,280,003	\$ 5,748,272	\$ 3,371,432
Capital and other assets	<u>93,263</u>	<u>8,027,982</u>	<u>8,939,096</u>
Total assets	<u>14,373,266</u>	<u>13,776,254</u>	<u>12,310,528</u>
Current liabilities	5,038,565	5,588,432	4,240,478
Long-term liabilities	<u>16,165,068</u>	<u>13,491,391</u>	<u>14,096,652</u>
Total liabilities	<u>21,203,633</u>	<u>19,079,823</u>	<u>18,337,130</u>
Net assets - Unrestricted	<u>(6,830,367)</u>	<u>(5,303,569)</u>	<u>(6,026,602)</u>
Total net assets	<u>\$ (6,830,367)</u>	<u>\$ (5,303,569)</u>	<u>\$ (6,026,602)</u>

Major Factors Affecting the Statements of Net Assets

Current year's net assets increased (decreased) by \$(1,526,798) and \$723,033 during the years ending June 30, 2008 and 2007, respectively, resulting mainly from the recording of claims including liability incurred but not reported (IBNR) amounts and actual claims paid out.

COMPARATIVE ANALYSIS (Continued)

Statements of Revenues, Expenses and Changes in Net Assets

A comparative summary of the Authority's Statements of Revenues, Expenses and Changes in Net Assets for the years ended June 30 which generally reflects its results of operations, is as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenue:			
Contributions from members	\$ 3,738,469	\$ 3,492,777	\$ 3,862,957
Excess insurance recovery and reimbursements	202,257	279,498	330,678
Interest income	571,647	614,489	504,319
Unrealized gain on investment	<u>144,142</u>	<u>115,140</u>	<u>-</u>
Total revenue	<u>4,656,515</u>	<u>4,501,904</u>	<u>4,697,954</u>
Expenses:			
Claims expense	2,505,941	2,118,774	3,287,306
Increase (decrease) in provision for claims and allocated claims adjustment expenses	2,212,888	236,663	(2,696,508)
Contract risk management services	375,311	339,009	255,698
Other risk management services	23,288	24,006	20,041
Other contract services - administration	101,266	110,000	102,000
General and administrative	137,742	161,779	135,251
Insurance expense	560,953	515,996	490,311
Interest expense	265,924	272,644	271,336
Unrealized loss on investment	<u>-</u>	<u>-</u>	<u>216,285</u>
Total expenses	<u>6,183,313</u>	<u>3,778,871</u>	<u>2,081,720</u>
Changes in net assets	<u>\$ (1,526,798)</u>	<u>\$ 723,033</u>	<u>\$ 2,616,234</u>

Major Factors Affecting the Statements of Revenues, Expenses and Changes in Net Assets

The increase in contributions in 2008 was caused by higher premiums being charged to the member cities. Interest income decreased due to lower rates of return. Claims expense and the incurred but not reported claims increased substantially based on the actuarial study performed.

COMPARATIVE ANALYSIS (Continued)

Reserves for Claims and Allocated Claims Adjustment Expenses

Reserves for Claims and Allocated Claims Adjustment Expenses for the years ended June 30 are calculated as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Reserves for unpaid claims and allocated adjustment expenses	\$ 1,185,341	\$ 2,691,093	\$ 4,750,348
Previously unrecorded IBNR claims	17,348,224	13,204,699	10,884,725
Reduction for temporary disability	(115,332)	(328,618)	(665,692)
Amount included in current accounts payable	(254,996)	(208,975)	(174,953)
Claims that met excess insurance limit	<u>(2,674,708)</u>	<u>(2,082,558)</u>	<u>(1,755,450)</u>
Total	<u>\$ 15,488,529</u>	<u>\$ 13,275,641</u>	<u>\$ 13,038,978</u>

FACTORS AFFECTING FUTURE PERIODS

There is no material factors affecting near future periods.

REQUESTS FOR INFORMATION

This financial report has been designed to provide a general overview of the Authority's accounting for anyone interested in its finances. Questions concerning any of the information should be addressed to the attention of the Chief Administrative Officer, 144 Montclair Drive, Santa Cruz, CA 95060.

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENTS OF NET ASSETS
JUNE 30, 2008 AND 2007

	2008	2007
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$ 7,376,335	\$ 4,054,540
Investments	6,772,535	1,594,369
Accounts receivable	20,295	16,313
Interest receivable	49,911	16,694
Prepaid expenses	60,927	66,356
Total current assets	14,280,003	5,748,272
NONCURRENT ASSETS:		
Investments	—	7,928,980
Note issuance costs—net	93,263	99,002
Total noncurrent assets	93,263	8,027,982
TOTAL ASSETS	14,373,266	13,776,254
<u>LIABILITIES</u>		
CURRENT LIABILITIES:		
Accounts payable	254,993	208,975
Deferred revenue	790,111	760,207
Claim and claim adjustment expense reserves	3,823,461	4,454,250
Current portion of long-term debt	170,000	165,000
Total current liabilities	5,038,565	5,588,432
LONG-TERM CLAIM AND CLAIM ADJUSTMENT RESERVES	11,665,068	8,821,391
LONG-TERM DEBT	4,500,000	4,670,000
<u>NET ASSETS (DEFICIT) —</u>		
Unrestricted	\$ (6,830,367)	\$ (5,303,569)

See Notes to Financial Statements.

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
REVENUES:		
Contributions from members:		
Workers' compensation	\$ 2,832,512	\$ 2,531,603
Liability	808,525	863,876
EAP and property insurance	97,432	97,298
Excess insurance recovery reimbursements	202,257	279,498
Total	3,940,726	3,772,275
EXPENSES:		
Claims expense	2,505,941	2,118,774
Increase in provision for claims and allocated claims adjustment expenses	2,212,888	236,663
Contract risk management services	375,311	339,009
Other risk management expenses	23,288	24,006
Other contract services – administration	101,266	110,000
General and administrative	137,742	161,779
Insurance expense:		
Workers' compensation	239,810	204,944
General liability	247,400	231,052
Property	73,743	80,000
Total	5,917,389	3,506,227
OPERATING INCOME (LOSS)	(1,976,663)	266,048
NONOPERATING REVENUE (EXPENSE):		
Interest income	571,647	614,489
Interest expense	(265,924)	(272,644)
Unrealized/realized gain on investment	144,142	115,140
CHANGES IN NET ASSETS	(1,526,798)	723,033
NET ASSETS (DEFICIT), BEGINNING OF YEAR	(5,303,569)	(6,026,602)
NET ASSETS (DEFICIT), END OF YEAR	\$ (6,830,367)	\$ (5,303,569)

See Notes to Financial Statements.

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Contributions received from members	\$ 3,764,391	\$ 4,125,298
Reimbursements received from recoveries	202,257	279,498
Cash paid for claims and other services	<u>(3,647,314)</u>	<u>(3,296,158)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>319,334</u>	<u>1,108,638</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Interest paid on debt	(265,924)	(272,644)
Principal payments on long-term debt	<u>(165,000)</u>	<u>(155,000)</u>
NET CASH (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(430,924)</u>	<u>(427,644)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment income received	827,045	611,559
Net withdrawal from investments	<u>2,606,340</u>	<u>947,991</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>3,433,385</u>	<u>1,559,550</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,321,795	2,240,544
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>4,054,540</u>	<u>1,813,996</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 7,376,335</u>	<u>\$ 4,054,540</u>

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007
(Continued)

	2008	2007
RECONCILIATION OF OPERATING INCOME (LOSS)		
TO NET CASH PROVIDED BY OPERATING		
ACTIVITIES:		
Operating income (loss)	\$ (1,976,663)	\$ 266,048
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Amortization	5,740	5,740
(Increase) decrease in –		
Accounts receivable	(3,982)	5,513
Prepaid expenses	5,429	(66,356)
Increase (decrease) in:		
Accounts payable	46,018	34,022
Deferred revenue	29,904	627,008
Reserves for claims and allocated claims adjustment expenses	2,212,888	236,663
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 319,334	\$ 1,108,638
 SUPPLEMENTAL INFORMATION –		
NONCASH INVESTING ACTIVITIES –		
Unrealized (gain) loss on investments	\$ (144,142)	\$ (115,140)

See Notes to Financial Statements.

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity – Monterey Bay Area Self Insurance Authority (the Authority) is a public agency created on July 1, 1983, by and among nine municipalities in California to provide a pooled approach to workers' compensation insurance. Since then, two municipalities have joined and one municipality has withdrawn. The Authority established a group to provide for liability insurance for certain electing members. The Authority is not a component unit of any entity and has no component units itself.

The Authority was created pursuant to Article I of Chapter 5, Division 7, Title I of the California Government code and was established to develop risk management programs, share the risk of self-insured losses, and jointly purchase excess insurance and administrative and other services.

It is governed by a Board of Directors which is comprised of the City Managers or their designated alternates from each of the member entities. Member cities at June 30, 2008, included Capitola, Del Rey Oaks, Gonzales, Greenfield, Hollister, King City, Marina, Sand City, Scotts Valley, and Soledad.

The Authority has certain administrative duties and obligations to its members including accounting, reporting, claims administration and investment of funds. Contribution rates are determined on the basis of individual member's claims experience. Members are required to participate in safety and risk reduction programs. Any member desiring to withdraw from participation will remain liable for any unpaid claims.

Basis of Accounting and Financial Statement Presentation – In accordance with generally accepted accounting principles (GAAP) applicable to Public Entity Risk Pools, the accounts of the Authority are organized into one proprietary fund, the Enterprise Fund, which has a measurement focus and a basis of accounting similar to a commercial enterprise which is appropriate to account for such entities.

Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenue and expense generally result from providing services and producing and delivering good in connection with an enterprise fund's principal ongoing operations. The Principal operating revenues of the Authority's enterprise fund is premiums collected from member entities. Operating expenses for enterprise funds include claims expense, administrative expense and insurance expense for excess of loss coverage.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Authority has adopted Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Authority's and Other Governmental Entities that Use Proprietary Authority Accounting*. Accordingly, the Authority has elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or after November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Cash and Cash Equivalents – For purposes of the statement of cash flows, only deposits in commercial bank accounts are considered cash equivalents.

Accounts Receivable – Receivables are accounted for using the allowance method. The allowances were zero at June 30, 2008 and 2007.

Self Insurance and Excess Insurance – The Authority covers losses in excess of \$10,000 for members of the liability group and carries excess insurance for losses between \$1,000,000 and \$20,000,000. Members of the workers' compensation group pay temporary disability claims directly, while the Authority pays for permanent disability claims, medical costs, rehabilitation costs, and legal costs and carries excess workers' compensation coverage for between \$500,000 and statutory.

Reinsurance – The Authority uses reinsurance agreements to reduce its exposure to large losses on all types of insured events. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Authority as direct insurer of the risks insured. The Authority does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers. The Authority is contingently liable with respect to certain loss coverage which would become a liability in the event the insurance carriers are unable to meet the obligations under these contracts.

Net Assets – Net assets represent the difference between assets and liabilities. If adequate provision has been made for the payment of all claims and expenses of the Authority, the Board of Directors, under certain conditions, may distribute surplus funds to past or present members, who were members for the prior fiscal year, or may carry forward the surplus to offset annual or supplemental payments in the subsequent fiscal year. In the event the Authority is terminated, all members of the Authority are obligated for any necessary supplemental payments applicable to the years during which they were members. After all claims and related expenses have been paid or reserves established for the payment of any such claims, any surplus funds will be distributed to members, past or present, who constituted the Authority for that year. Net assets are reported as restricted when there are limitations imposed on their use either through external restrictions imposed by creditors, grantors or laws or regulations of other governments. Net assets not subject to such limitations are reported as unrestricted.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Claim and Claim Adjustment Expense Reserves – Claim and claim adjustment expenses are charged to income as incurred. Claim and Claim adjustment expense reserves represent the accumulation of estimates for reported unpaid losses including claim adjustment expenses, the effects of inflation and other societal and economic factors, plus a provision for losses incurred but not reported. Claim adjustment expenses represent anticipated costs of settling claims, including attorneys' and adjusters' fees. the reserves for incurred but not reported claim and claim adjustment expenses are actuarially determined and based on a computation that applies varying percentages to each policy year's earned contributions, less cumulative claims paid and reported unpaid loss reserves at the balance sheet date. The methods for making such estimates and for establishing the resulting liability are continually reviewed and any adjustments are reflected in earnings.

Use of Estimates – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates.

Budget – The Board of Directors adopts an annual budget prepared on the cash basis of accounting.

Reclassification of Prior Year Amounts – Certain reclassifications have been made to the 2007 totals to conform with the current year financial statement presentation.

NOTE 2. DEPOSITS AND INVESTMENTS

Deposits – All deposits with financial institutions must be collateralized in an amount equal to 110% of uninsured deposits. The collateral must be held by the pledging financial institutions' trust departments or agents.

Custodial Credit Risk Related to Deposits – Custodial credit risk is the risk that, in the event of a bank failure, the City's deposits might not be recovered. The Authority does not have a deposit policy for custodial credit risk. As of June 30 the following amounts were exposed to custodial credit risk:

	<u>2008</u>	<u>2007</u>
Total deposit amounts	\$ 7,411,713	\$ 4,301,384
Insured by FDIC	<u>(100,000)</u>	<u>(100,000)</u>
Uncollateralized (including bank balances of \$7,311,713 that are collateralized with securities held by the pledging financial institution's agent but not in the name of the Authority).	<u>\$ 7,311,713</u>	<u>\$ 4,201,384</u>

NOTE 2. DEPOSITS AND INVESTMENTS (Continued)

Investments – The Authority’s investment policy is designed to follow the California Government Code Sections 53600 et seq. Within the context of the limitations, the following investments are authorized:

United States Treasury Bills, Bonds and Notes

Obligations issued by Federal Agencies such as the Government National Mortgage (GNMA) the Federal Farm Credit System (FFCB), the Federal Home Loan Bank Board (FHLB), the Federal National Mortgage Association (FNMA), the Student Loan Marketing Association (SLMA), and the Federal Home Loan Mortgage Association (FHLMC).

In addition, the Authority may invest in Banker’s Acceptances, commercial paper ranked P1 by Moody’s Investor Services or A1+ by Standard & Poor’s, Certificate of Deposits, Repurchase Agreements, Reverse Repurchase Agreements, Local Agency Investment Fund, the pooled cash program of the Treasurer of Santa Cruz County, Time Deposits, and Medium Term Corporate Notes. All of the above investments are further restricted by specific maturity periods and their proportionate value to the total portfolio.

All securities owned by the Authority shall be held in safekeeping by a third party bank trust department, acting as an agent for the Authority under the terms of a custody agreement. Collateral is required for investments in certificates of deposits, repurchase agreements and reverse repurchase agreements at the level of at least 102% of market value of principal and accrued interest.

Custodial Credit Related to Investments – The custodial credit risk for investment is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the transaction fails. The Authority’s investment policy is designed to mitigate the custodial credit risk by investing in investment grade securities and by diversifying the investment portfolio, so that the failure of any one issuer does not unduly harm the Authority’s capital base and cash flow.

As of June 30 the following amounts were exposed to custodial credit risk;

	<u>2008</u>	<u>2007</u>
Total investment balance	\$ 6,772,535	\$ 9,523,349
Less:		
Investments not subject to categorization	6,470,180	1,282,366
Investments with no credit risk	<u>302,355</u>	<u>7,237,903</u>
Insured or registered securities held by the entity or its agent	<u>\$ –</u>	<u>\$ 1,003,080</u>

Concentration of Credit Risk – There is a concentration of credit risk when the amount of investment in any one entity is at least 5% of total investments except investments held in the U.S. Government or investments guaranteed by the U.S. Government. At June 30, the Authority held corporate bonds by a single issuer in the amount of zero and \$1,003,080 which made up approximately 0% and 11%, respectively of total investment as of June 30, 2008 and 2007, respectively.

NOTE 2. DEPOSITS AND INVESTMENTS (Continued)

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The amount of loss in the fair value of a fixed-income security increases as the current market interest rate related to the investment rises. It is the Authority's policy to structure the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and to investing operating funds primarily in shorter-term securities. This policy is designed to minimize the interest rate risk.

NOTE 3. CLAIM AND CLAIM ADJUSTMENT EXPENSE RESERVES – WORKER'S COMPENSATION

Activity in the claim and claim adjustment expense reserves for the years ended June 30 was as follows:

	<u>2008</u>	<u>2007</u>
Claim and Claim adjustment expense reserves, beginning of year, net of reinsurance recoverable of \$2,082,558 in 2007 and \$1,755,450 in 2006	\$ 11,384,037	\$ 11,162,035
Incurred claim and claim adjustment expenses:		
Provision for insured events – current year	3,400,000	4,486,641
Provision for insured events – prior years	<u>1,033,663</u>	<u>(2,444,699)</u>
Total incurred claim and claim adjustment expenses	<u>4,433,663</u>	<u>2,041,942</u>
Payments:		
Claim and claim adjustment expenses attributable to insured events – current year	434,224	864,346
Claim and claim adjustment expenses attributable to insured events – prior years	<u>1,647,738</u>	<u>955,594</u>
Total payments	<u>2,081,962</u>	<u>1,819,940</u>
Claim and claim adjustment expense reserves, end of year, net of reinsurance recoverable of \$2,674,708 in 2008 and \$2,082,558 in 2007.	\$ 13,735,738	\$ 11,384,037

The provision for prior year insured events represents the variations between the Authority's estimated claims payable for prior years' claims and the actual amounts required to satisfy such claims.

NOTE 4. CLAIM AND CLAIM ADJUSTMENT EXPENSE RESERVES – LIABILITY

Activity in the claim and claim adjustment expense reserves for the years ended June 30 was as follows:

	<u>2008</u>	<u>2007</u>
Claim and claim adjustment expense reserves, beginning of year, net of reinsurance recoverable of \$ –0– in 2007 and \$ –0– in 2006.	\$ 1,891,604	\$ 1,876,943
Incurred claim and claim adjustment expenses:		
Provision for insured events – current year	873,013	840,642
Provision for insured events – prior years	<u>(625,490)</u>	<u>(527,147)</u>
Total incurred claim and claim adjustment expenses	<u>247,523</u>	<u>313,495</u>
Payments:		
Claim and claim adjustment expenses attributable to insured events – current year	15,328	8,689
Claim and claim adjustment expenses attributable to insured events – prior years	<u>371,008</u>	<u>290,145</u>
Total payments	<u>386,336</u>	<u>298,834</u>
Claim and claim adjustment expense reserves, end of year, net of reinsurance recoverable of \$ –0– in 2008 and \$ –0– in 2007.	<u>\$ 1,752,791</u>	<u>\$ 1,891,604</u>

The provision for prior year insured events represents the variations between the Authority's estimated claims payable for prior years' claims and the actual amounts required to satisfy such claims.

NOTE 5. LONG-TERM DEBT

Long-term debt at June 30 consists of the following:

	<u>2008</u>	<u>2007</u>
Note payable to DEPPFA Bank. Annual payments including interest are due on annual basis. The loan bears interest at an initial rate of 5.5% per annum. The note matures October 1, 2024. The note is secured by all premiums received by the Authority.	\$ 4,670,000	\$ 4,835,000
Total	4,670,000	4,835,000
Less current portion	<u>(170,000)</u>	<u>(165,000)</u>
Total long-term debt	<u>\$ 4,500,000</u>	<u>\$ 4,670,000</u>

NOTE 5. LONG-TERM DEBT (Continued)

Long-term debt maturities at June 30, 2008 are as follows:

	<u>Interest</u>	<u>Principal</u>
2010	249,750	180,000
2011	239,760	190,000
2012	229,215	205,000
2013	217,838	215,000
2014 – 2018	205,905	1,260,000
2019 – 2023	135,975	1,650,000
2024 – 2025	44,400	800,000
	<u> </u>	<u> </u>
Total	<u>\$ 1,322,843</u>	<u>\$ 4,500,000</u>

NOTE 6. NOTE ISSUANCE COSTS

Note issuance costs represent legal and accounting fees, preparation costs and other expenses associated with the issuance of long-term debt note. Such costs are being amortized over the term of the note. The balance as of June 30 is presented as follows:

	<u>2008</u>	<u>2007</u>
Original cost	\$ 114,785	\$ 114,785
Less accumulated amortization	<u>(21,522)</u>	<u>(15,783)</u>
	<u> </u>	<u> </u>
Debt issuance costs – net	<u>\$ 93,263</u>	<u>\$ 99,002</u>

Amortization expense for the years ended June 30, 2008 and 2007 is \$5,739.

REPORT REQUIRED BY
GOVERNMENT AUDITING STANDARDS

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

**To the Board of Directors
Monterey Bay Area Self Insurance Authority
Santa Cruz, California**

We have audited the financial statements of the *Monterey Bay Area Self Insurance Authority* as of and for the years ended June 30, 2008 and 2007, and have issued our report thereon dated January 16, 2009. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered *Monterey Bay Area Self Insurance Authority's* internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the *Monterey Bay Area Self Insurance Authority's* internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the *Monterey Bay Area Self Insurance Authority's* internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be presented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance

As part of obtaining reasonable assurance about whether the *Monterey Bay Area Self Insurance Authority's* financial statements are free of 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 that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of *Monterey Bay Area Self Insurance Authority* in a separate letter dated January 16, 2009.

This report is solely intended for the information of the Board of Directors and management and is not intended to be and should not be used by anyone other than those specified parties.

January 16, 2009

Harjathi + Wayland

SUPPLEMENTARY INFORMATION

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENT OF REVENUES AND EXPENSES – BUDGET AND ACTUAL
WORKERS' COMPENSATION
FOR THE YEAR ENDED JUNE 30, 2008

	2008		Variance Favorable (Unfavorable)
	Budgeted	Actual	
REVENUES:			
Contributions from members	\$ 2,832,512	\$ 2,832,512	\$ –
Excess insurance recovery reimbursements	<u>60,000</u>	<u>121,456</u>	<u>61,456</u>
Total revenues	<u>2,892,512</u>	<u>2,953,968</u>	<u>61,456</u>
EXPENSES:			
Claims expense	2,332,000	2,081,962	250,038
Contract risk management services	256,619	253,083	3,536
Other contract services – administration	50,000	50,633	(633)
Other contract services	45,100	–	45,100
General and administrative	57,250	98,317	(41,067)
Insurance expense	225,000	239,810	(14,810)
Contingency reserve	<u>100,000</u>	<u>–</u>	<u>100,000</u>
Total expenses	<u>3,065,969</u>	<u>2,723,805</u>	<u>342,164</u>
Operating income (loss) before reconciliation for non – budgeted items	<u>\$ (173,457)</u>	230,163	<u>\$ 403,620</u>
Accrued expenses – Increase in provision for claims and allocated claims adjustment expenses		<u>(2,351,701)</u>	
OPERATING INCOME (LOSS)		<u>\$ (2,121,538)</u>	

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
STATEMENT OF REVENUES AND EXPENSES – BUDGET AND ACTUAL
LIABILITY
FOR THE YEAR ENDED JUNE 30, 2008

	2008		Variance Favorable (Unfavorable)
	Budgeted	Actual	
REVENUES:			
Contributions from members	\$ 808,525	\$ 808,525	\$ –
Reimbursements	–	80,801	80,801
Total revenues	<u>808,525</u>	<u>889,326</u>	<u>80,801</u>
EXPENSES:			
Claims expense	254,000	423,979	(169,979)
Contract risk management services	46,300	122,228	(75,928)
Other contract services – administration	50,000	50,633	(633)
General and administrative	23,225	39,425	(16,200)
Insurance expense	250,000	247,400	2,600
Contingency reserve	100,000	–	100,000
Total expenses	<u>723,525</u>	<u>883,665</u>	<u>(160,140)</u>
Operating income (loss) before reconciliation for non-budgeted items	<u>\$ 85,000</u>	5,661	<u>\$ (79,339)</u>
Accrued expenses – Decrease in provision for claims and allocated claims adjustment expenses		<u>138,813</u>	
OPERATING INCOME		<u>\$ 144,474</u>	

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
WORKERS' COMPENSATION
JUNE 30, 2008

The rows of the table on page 27 are defined as follows:

- (1) This line shows the total of each fiscal year's gross earned premiums and reported investment revenue.
- (2) This line shows each fiscal year's other operating costs of the fund, including overhead and claim adjustment expenses not allocable to individual claims.
- (3) This line shows the Authority's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).
- (4) This section of 10 rows shows the cumulative amounts paid as of the end of successive years for each policy year.
- (5) This section of 10 rows shows how each policy year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received in known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known.
- (6) This line compares the latest re-estimated incurred claims amount to the amount originally established (line 1) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature years. The columns of the table show data for successive policy years.

MONTEREY BAY AREA SELF INSURANCE AUTHORITY
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
LIABILITY
JUNE 30, 2008

The rows of the table on page 29 are defined as follows:

- (1) This line shows the total of each fiscal year's gross earned premiums and reported investment revenue.
- (2) This line shows each fiscal year's other operating costs of the fund, including overhead and claim adjustment expenses not allocable to individual claims.
- (3) This line shows the Authority's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).
- (4) This section of 10 rows shows the cumulative amounts paid as of the end of successive years for each policy year.
- (5) This section of 10 rows shows how each policy year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received in known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known.
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