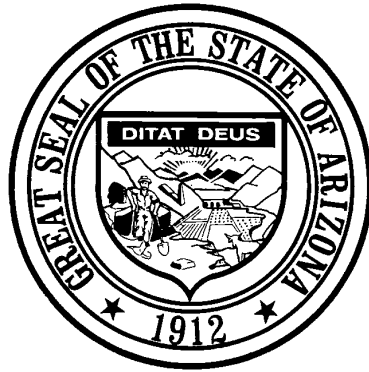


**ARIZONA DEPARTMENT OF ADMINISTRATION
RISK MANAGEMENT SECTION**

**JANET NAPOLITANO
GOVERNOR**

**WILLIAM BELL
DIRECTOR**



FISCAL YEAR 2006 ANNUAL REPORT

RESPONSIBILITIES/STATUTES

The Fiscal Year 2006 Annual Report, as required by A.R.S. §41-623, summarizes liability, property, and workers' compensation expenditures; and provides information on the loss prevention efforts and overall achievements of the Risk Management Section during the fiscal year.

The Risk Management Section of the Arizona Department of Administration, established in 1976, is tasked with the management of liability, property and workers' compensation claims. Statutes found in A. R. S. §41-621 et seq. and administrative rules found in A.A.C. R2-10-101 through R2-10-601 outline the parameters of the program, including coverage for agencies, employees, boards and commissions. The Risk Management Section provides consultants to state agencies to help agency personnel develop specific programs that reduce or eliminate risk to the state. On an annual basis, Risk Management performs a comprehensive evaluation to determine the proper mix of purchased commercial insurance and risk retention.

Funding for Risk Management programs is provided through the Permanent Risk Management Revolving Fund. Revenues into the fund are received as follows:

- An actuarial projection is developed for property and liability expenditures, outside counsel and allocated loss adjustment expenditures. In addition, estimates are prepared for costs of administration, insurance premiums and Attorney General Defense. The total is then allocated to agencies based on a formula that assesses risk exposure as well as historical losses. Each agency is then billed for its allocated share.
- An actuarial projection is also developed for workers' compensation time loss expenditures, medical, outside counsel and allocated loss adjustment expenditures. In addition, estimates are prepared for costs of administration, insurance premiums, and Attorney General Defense. A formula is used to divide the total funding requirement to agencies, using the classification of the employee modified by the historical losses of the particular agency.

Achievements and Growth

Fiscal Year 2006 marked a year of significant achievements and continued growth of the Risk Management Division.

- As a result of the ADOA External Customer Survey, Risk Management received four Director's Awards. The Property & Liability Claims Unit, the Workers' Compensation Unit and the Insurance Unit received the Director's Excellence Award for receiving a satisfactory rating over 6.5 (scale:1-8, 8 being high). In addition, the Workers' Compensation Unit received the Director's Recognition Award for achieving an increase in customer satisfaction for three consecutive years.
- In Fiscal Year 2006, 9,966 state employees completed Loss Prevention training in various defensive driving courses. The 1,220 classes conducted during the fiscal year included Train-the-Trainer, Behind-the-Wheel, Van Dynamics and Van Dynamics Instructor training, and Top Driver and Top Driver Instructor Training.
- The Risk Management Workers' Compensation Unit sponsored a seminar aimed at identifying red flags in the claims reporting process. The seminar was attended by 58 state agency workers' compensation liaisons.
- The insurance component of the Risk Management Web site was updated to assist customers and provide agency support with understanding insurance and indemnification module guidelines for State of Arizona contracts, invitation for bids, leases, and requests for proposals.
- During Fiscal Year 2006, 430 lawsuits were brought against the state; all but 10 settled without going to trial. Of the ten that went to trial, Risk Management prevailed in seven.
- Fiscal Year 2006 marked the sixth consecutive year in which the Workers' Compensation Incident Rate decreased. A favorable trend in auto frequency has been achieved in the last three fiscal years.
- Loss Prevention established a training course entitled "*Dynamics of Risk, Risk Management and Insurance*". The course is intended for any state employee with at least one year experience and/or in a supervisory position who need to learn the technical aspects of risk terminology, concepts of risk management, and insurance.
- Loss Prevention implemented the quarterly newsletter, Focus, as a communication piece aimed at increasing agency safety awareness.
- Information Technology implemented a new terminal server. The terminal server allows Risk Management "at home" employee access to the RMIS servers, should an event cause a shutdown of office operations.

FISCAL YEAR 2006 COSTS AND COMPARISONS

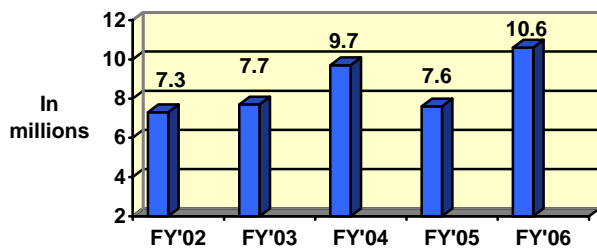
Property expenditures in FY 2006 were \$10.6 million, which is an increase of \$3 million from FY 2005; and \$2 million greater than the five-year average of \$8.6 million.

Liability expenditures for FY 2006 were \$28.2 million, up from \$27.3 million in FY 2005. The five-year average for liability expenditures is \$29 million.

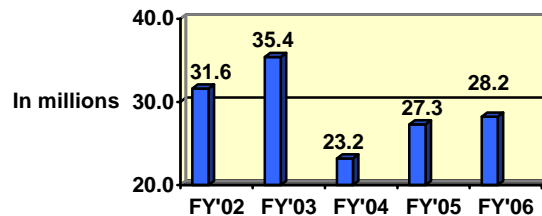
Workers' Compensation expenditures in FY 2006 increased by \$800,000 over FY2005; \$19.9 million versus \$19.1 million.

The following charts depict five-year comparisons, distribution of total costs for the year, and distribution of claims by loss type for the year.

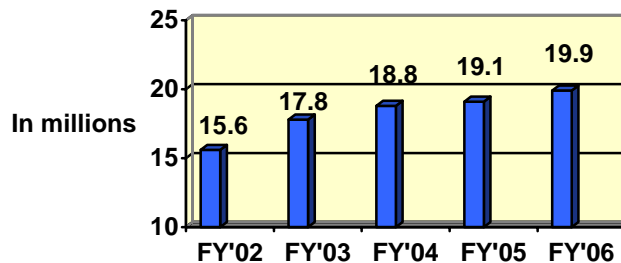
PROPERTY CLAIM COSTS



LIABILITY CLAIM COSTS



WORKERS' COMPENSATION CLAIM COSTS



LIABILITY PROGRAM

In the Fiscal Year 2006, there were 2,722 liability claims reported to the Risk Management Division against the state of Arizona. Figure 1 details the General Liability Categories insured by the Risk Management Division. Automobile liability includes third party claims for injuries and property damage resulting from the use of automobiles by state employees engaged in state business. General liability includes third party bodily injury and property damage, highway maintenance, and negligence in oversight of state-managed programs. Medical Malpractice includes errors and omissions by State medical professionals. The category of personal injury includes such areas as employment discrimination, defamation, and civil rights violations. Figure 1 shows the number of incidents reported in Fiscal Year 2006 listed by agencies with the most frequent occurrences of liability losses.

Figure 1

	Auto Liability Bodily Injury	Auto Liability Property	General Liability Bodily Injury	General Liability Property	Medical Malpractice	Personal Injury
Department of Transportation	28	85	114	465	0	6
Department of Corrections	28	42	50	339	7	138
Department of Public Safety	23	196	25	27	0	21
Department of Administration	6	74	5	17	0	10
Department of Economic Security	10	74	45	132	0	46
University of Arizona	1	41	8	19	24	16
Northern Arizona University	1	11	10	11	0	4
Arizona State University	4	30	26	27	3	21
All Other Agencies	5	59	181	74	8	125
Total Reported Incidents	106	612	464	1111	42	387

Figure 2 shows the actual expenditures paid in the Fiscal Year 2006 for liability claims including defense and allocated loss adjustment expenditures. Total liability claim

payments for Fiscal Year 2006 were \$28.2 million. The ten agencies with the highest losses are ranked in descending order.

Figure 2

Agency	Liability Claims
Department of Transportation	\$ 6,682,642
Department of Economic Security	\$ 5,772,145
State Superior Courts	\$ 4,485,322
Department of Corrections	\$ 3,910,485
University of Arizona	\$ 2,340,045
Department of Public Safety	\$ 1,193,276
Department of Administration	\$ 698,766
Arizona State University	\$ 685,729
Board of Examiners of Nursing Care Administrators and Assisted Living Facility Managers	\$ 346,602
Northern Arizona University	\$ 338,956
Sub-Total	\$26,453,968
All Other Agencies	\$ 1,773,045
Total	\$28,227,013

General Liability – Bodily Injury claims were the most expensive claims in the liability category, representing 60% of the total cost. Personal injury was second and represented 15% of the total cost. Medical malpractice payments were \$4,263,937. The following table breaks down the number of claims and amounts paid by loss type:

Figure 3

Loss Type	Frequency	Severity
Automobile Liability – Bodily Injury	106	\$ 1,067,798
Automobile Liability – Property	612	\$ 514,936
General Liability – Bodily Injury	464	\$16,891,107
General Liability – Property	1111	\$ 1,158,651
Medical Malpractice	42	\$ 4,263,937
Personal Injury	387	\$ 4,330,584
Total	2722	\$28,227,013

PROPERTY PROGRAM

In Fiscal Year 2006, there were 5,177 property claims filed by state agencies.

The top two loss categories by frequency of occurrence and severity of payments were real and personal property. Real property covers facilities owned by the state such as office buildings, prison facilities and general infrastructure. Personal property includes state owned vehicles, furniture, computers and other tangible property excluding land or buildings. Figure 4 shows the frequency and severity for property losses.

Figure 4

Loss Type	Frequency	Severity
Real Property	696	\$4,131,445
Personal Property	4444	\$4,945,316
Environmental Property	19	\$1,128,438
Boiler and Machinery	13	\$93,625
Aircraft Hull	4	\$120,225
Fidelity and Surety	1	\$212,436
Total	5177	\$10,631,485

The following table shows the amount of payments made in Fiscal Year 2006 for the various property losses for the agencies with the largest losses ranked in descending order.

Figure 5

Agency	Property Losses
University of Arizona	\$ 1,735,379
Department of Corrections	\$ 1,365,004
Department of Transportation	\$ 1,249,581
Department of Public Safety	\$ 1,106,438
Department of Administration	\$ 935,689
State Land Department	\$ 778,899
Arizona State University	\$ 705,963
Northern Arizona University	\$ 621,794
Department of Health Services	\$ 379,291
Department of Education	\$ 334,757
Sub-Total	\$ 9,212,795
All Other Agencies	\$ 1,418,690
Total	\$10,631,485

WORKERS' COMPENSATION PROGRAM

The State Workers' Compensation Program provides benefits to state employees injured in the course and scope of their employment. The program pays medical, surgical, lost wages and hospital disability benefits as provided by law under the Arizona Workers' Compensation Act.

In Fiscal Year 2006, the Workers' Compensation costs increased from Fiscal Year 2005 by \$800,000. Rising medical costs have been contained by a reduction in frequency.

The Managed Care Incentive Program provides quality medical care for state employees injured on the job. More than 48 hospitals, 3000 physicians and 12 industrial clinics are available to employees within the network.

The Early Claims Notification System continues to be successful. This system involves early notification of workers' compensation claims by injured state employees or their supervisors. Studies confirm that early notification allows for early claims management intervention which translates to cost savings. The 542-WORK phone line, allows injured employees or their supervisors to call in the first report of an industrial injury to the workers' compensation unit 24 hours a day, 7 days a week. During non-business hours, state employees are able to respond to questions regarding their injury via an automated system.

The Early Return to Work with Modified Duty Program continues to prove effective in many state agencies. A disability management specialist works with injured workers, their supervisors and managers to find positions within their agency that allow the injured worker to return to work as soon as possible. Placing an injured worker in these modified duty positions enables the employee to make a smooth and safe transition to their former duties or to a new position that is suitable for them.

In addition to managing the Modified Duty Program, the disability management nurse has helped to implement the in-house Utilization Review Program. All medical diagnostic procedures must be reviewed for medical necessity and appropriateness before authorization. This process is typically completed within 24 hours to help ensure the recovery of injured employees.

Figure 7 ranks the severity of payments for workers' compensation claims in Fiscal Year 2006 by agency.

Figure 7

Agency	WC Losses
Department of Corrections	\$ 4,598,224
Department of Economic Security	\$ 2,460,187
Department of Transportation	\$ 1,815,983
University of Arizona	\$ 1,630,867
Department of Public Safety	\$ 1,355,805
Arizona State University	\$ 1,053,810
Department of Health Services	\$ 928,295
Northern Arizona University	\$ 701,741
State Superior Courts	\$ 639,614
Department of Juvenile Corrections	\$ 631,474
Sub-total	\$15,816,000
All other agencies	\$ 4,091,338
Total	\$19,907,338

Figure 8 shows frequency of claims accepted in Fiscal Year 2006.

Figure 8

Agency Ranking	Claims Accepted
Department of Corrections	777
University of Arizona	427
Department of Economic Security	359
Department of Transportation	236
Arizona State University	339
Department of Public Safety	211
Superior Courts	157
Northern Arizona University	147
Department of Juvenile Corrections	159
Department of Health Services	135
All Other Agencies	512
Total of All Agencies	3459

LOSS PREVENTION PROGRAM

The Arizona Revised Statutes require each state agency to conduct risk identification and assessment, and implement a loss prevention program to reduce the frequency and severity of losses in the following areas:

- Real and personal property protection
- Employee safety in the work environment
- Federal and State standards for industrial hygiene and environmental protection
- Negligent acts that cause harm to third-parties

The primary responsibility of the Loss Prevention Unit is to work with state agencies to reduce or eliminate their exposure to risk. Risk Management Loss Prevention provides professional services in a variety of areas including property, liability, environmental, and worker protection.

Loss Prevention provides professional Safety Consultants, Industrial Hygienists and Environmental Specialists to assist agencies in developing and implementing loss prevention programs. The Safety Consultants also provide assistance in solving everyday loss prevention problems in the following areas:

- Construction Safety
- Industrial Safety
- Hazard Communication
- Fire Safety
- Fair Safety
- Security
- Course of Construction
- Motor Vehicle Safety
- Emergency Planning
- Site and Hazard Assessment
- Health and Safety Education
- CPR
- Ergonomics

Assistance is provided in risk assessment and corrective action, program development and implementation by means of Assessment, Consultation, and Evaluation (ACE) Reports. An ACE report is a focused inspection and consultation to assess a particular risk exposure, along with written recommendations for corrective actions. In Fiscal Year 2006, sixty-nine ACE reports were provided to twenty-five state agencies. The top three ACE subjects and recommended corrective actions are:

Fire and Security

- Fire Extinguisher Inspection, Maintenance, Service and Training
- Training on Fire Protection Practices
- Wildfire Preventative Actions
- Security Lighting Enhancements
- Fire Door Repair

Safety Inspection

- Guardrail Installation
- Emergency Evacuation Plans (Drills)
- Repair of Emergency Lighting/Exit Signs
- Secure Machinery

Building Indoor Air Quality

- Air Diffuser Cleaning
- General HVAC Maintenance
- Mold Consultation/Testing/Mitigation

In Fiscal Year 2006, Loss Prevention completed a three-year project evaluating the top thirty-six agency loss prevention program elements required under R2-10-207.

Revisions to the Loss Prevention Fleet Rule R2-10-207 (12) and Deductibles and Waivers R2-10-108 were initiated.

On July 1, 2005 Loss Prevention Training was transferred to the Arizona Government University (AZGU). AZGU offers a variety of safety training classes including: Defensive Driving, CPR/AED, First Aid, Back Safety, Fire Protection, Office Ergonomics, Crisis Intervention and the Loss Prevention Safety Academy.

OCCUPATIONAL HEALTH SERVICES

Occupational Health Services is responsible for the post offer physical examinations of potential state employees. Occupational Health Services schedules, evaluates, and pays for these examinations for various state agencies.

In Fiscal Year 2006, 1,608 post-offer exams were conducted. The average number of days to process exam findings was less than one day. Processing exam findings measure the turn-around period from the time the staff nurse receives the perspective state employee's medical information until the agency is notified of the candidate's status.

The total cost for Occupational Health Services in Fiscal Year 2006 was \$102,264.