

AN AUDIT

*Local Government Property
Insurance Fund*

Office of the Commissioner of Insurance

00-12

November 2000

1999-2000 Joint Legislative Audit Committee Members

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State of Wisconsin \ LEGISLATIVE AUDIT
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November 3, 2000

Senator Gary R. George and
Representative Carol Kelso, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Kelso:

As required by s. 13.94(1)(de), Wis. Stats., we have completed a financial audit of the Local Government Property Insurance Fund, which provides property insurance to counties, towns, villages, school districts, and other local units of government and is administered by the Office of the Commissioner of Insurance. As of June 30, 2000, the Property Fund insured 1,113 local units of government with an insured property value of approximately \$25.1 billion. We were able to provide an unqualified auditor's report on the Property Fund's financial statements for the fiscal years ending June 30, 2000, 1999, and 1998.

The Property Fund earned net income totaling \$4.3 million for the three-year period ended June 30, 2000, and as of that date had a surplus of \$23.4 million. The Property Fund surplus, which has been an issue discussed in prior audit reports, is still being maintained at a level above the industry standard. The Office of the Commissioner of Insurance monitors the surplus level and believes it is currently appropriate considering recent loss experience. The Property Fund had several large fire and windstorm claims during the last three years, but reinsurance limited the effect of these losses on the Fund. If the Fund's loss experience results in increased reinsurance premiums and coverage levels in the future, its fund surplus can help limit the effect of future reinsurance increases on policyholder premiums and help ensure a financially stable program.

We appreciate the courtesy and cooperation extended to us by the staff of the Office of the Commissioner of Insurance and the private firms responsible for the administration of the Property Fund.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/cm

SUMMARY

The Local Government Property Insurance Fund provides property insurance coverage to local units of government such as counties, towns, cities, villages, school districts, and library boards. The Property Fund must accept any local unit of government that wishes to participate and it cannot place restrictions on the type of property covered. As of June 30, 2000, the Property Fund insured 1,113 local units of government. The Office of the Commissioner of Insurance, which has statutory responsibility for administering the Property Fund, contracts most of the administrative activities to private firms.

Section 13.94(1)(de), Wis. Stats., requires the Legislative Audit Bureau to perform audits of the Property Fund. As necessary parts of the financial audit, we reviewed the Property Fund's control procedures; assessed the fair presentation of its financial statements for fiscal years (FYs) 1999-2000, 1998-99, and 1997-98; and reviewed compliance with statutory provisions. We were able to provide an unqualified auditor's report on the Property Fund's financial statements, and we found no instances of material weaknesses in the internal control structure or instances of noncompliance. Further, we found that the Property Fund had addressed past concerns with overdue premium receivables and errors in the calculation of premiums.

The Local Government Property Insurance Fund earned annual net income ranging from \$1.0 million to \$1.8 million during FYs 1999-2000, 1998-99, and 1997-98. As of June 30, 2000, the Property Fund had a surplus of \$23.4 million, which represented an increase of \$4.3 million over the three-year period. The Office of the Commissioner of Insurance monitors the surplus level and believes it currently is appropriate considering recent loss experience and expectations that reinsurance premiums may increase in light of these losses.

During the last three years, the Property Fund had several large claims, including a \$4.2 million claim for a fire at the Delavan-Darien School District in FY 1997-98. In addition, the Property Fund had claims for several wind storms during the last three years, including claims totaling \$2.6 million from wind storms occurring over a three-day period in FY 1998-99.

The Property Fund purchases reinsurance to reduce its exposure to large losses, and the effect of the large losses the Fund experienced during the three years audited was limited by reinsurance. Reinsurance pays the Property Fund for claim amounts in excess of \$500,000. In addition, once the Fund has incurred \$6.0 million in claims in aggregate for the year, reinsurers pay for all claims, less a \$10,000 deductible per claim, above the aggregate \$6.0 million level. The Fund reached the aggregate reinsurance level in each of the three years. Reinsurance recoveries for losses incurred during the three-year period totaled an estimated \$19.2 million. In comparison, the Property Fund paid a total of only approximately \$4.0 million in reinsurance premiums for the

three-year period. Therefore, the Property Fund anticipates that bids for the next reinsurance contract, which will be effective for FY 2001-02, are likely to include significantly higher reinsurance premiums and to raise the threshold at which reinsurers begin to pay for losses. The Property Fund's surplus can help limit the effect of future reinsurance increases on policyholder premiums and help ensure a financially stable program.

INTRODUCTION

The Local Government Property Insurance Fund is a state-sponsored program that provides property insurance coverage to local units of government such as counties, cities, towns, villages, and school districts. The Office of the Commissioner of Insurance (OCI), which has statutory responsibility for administering the Property Fund, contracts with private firms for most administrative activities, such as issuing policies, collecting premiums, and paying claims. OCI assigns one full-time employee to serve as its liaison with private contractors and to answer technical questions raised by the contractors and policyholders.

Policyholder premiums and investment earnings finance Property Fund claim payments and administrative expenses. Participating governmental units pay annual premiums based on the value of their insured property.

By law, the Legislative Audit Bureau is responsible for performing financial audits of the Property Fund. As necessary parts of this financial audit, we reviewed the Property Fund's control procedures; assessed the fair presentation of its financial statements for fiscal years (FYs) 1999-2000, 1998-99, and 1997-98; and reviewed its compliance with statutory provisions. We also followed up on concerns from our prior audit (report 97-22) relating to overdue premium receivables and errors in the calculation of premiums. In performing our audit, we reviewed the Property Fund's records and supporting documentation and discussed issues concerning the Property Fund with OCI staff and the fund administrator.

Fund History

The Property Fund grew out of the State Property Insurance Fund, which was created in 1903 for the purpose of uniformly insuring all state properties against loss or damage caused by fire, windstorm, burglary, vandalism, and other external factors. Coverage was extended to include the property of counties, towns, cities, villages, school districts, and library boards in 1911 and 1913, when it was difficult for these units of government to obtain reasonably priced coverage in the private sector. In 1979, the State Property Insurance Fund was re-created by the Legislature as the Local Government Property Insurance Fund, whose purpose is to insure nonstate-owned government properties. Coverage of state-owned property was transferred to a self-funded program administered by the Wisconsin Department of Administration.

The Property Fund covers all property losses except flood, earthquake, wear and tear, extremes in temperature, war, nuclear reaction, and embezzlement. The Property Fund must accept any local unit of government that wants to participate and cannot limit the type of property covered. The Property Fund does not advertise or pay sales

commissions to insurance agents and does not actively solicit business. Local units of government generally become aware of the Property Fund by word of mouth.

As of June 30, 2000, the Property Fund insured 1,113 local units of government with an insured property value of approximately \$25.1 billion. Table 1 shows the number and type of governmental units participating in the Property Fund in the past five years.

Table 1

Number and Type of Policyholders as of June 30

<u>Governmental Unit</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Counties	69	70	70	70	71
School Districts	273	282	291	277	282
Cities	137	137	138	137	137
Towns	280	304	319	329	308
Villages	194	207	211	206	203
Miscellaneous	<u>93</u>	<u>99</u>	<u>109</u>	<u>108</u>	<u>112</u>
Total	1,046	1,099	1,138	1,127	1,113
Insurance in force (in billions)	\$18.8	\$19.4	\$21.5	\$22.8	\$25.1

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF THE LOCAL GOVERNMENT PROPERTY INSURANCE FUND

We have audited the accompanying balance sheet of the State of Wisconsin Local Government Property Insurance Fund as of June 30, 2000, 1999, and 1998, and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the years then ended. These financial statements are the responsibility of the management of the Local Government Property Insurance Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Local Government Property Insurance Fund and are not intended to present fairly the financial position of the State of Wisconsin and the results of its operations and changes in financial position of its proprietary and trust fund types in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Property Insurance Fund as of June 30, 2000, 1999, and 1998, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The required supplementary information on claims development information on pages 21 and 22 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 26, 2000, on our consideration of the Local Government Property Insurance Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations.

LEGISLATIVE AUDIT BUREAU

October 26, 2000

by

Diann Allsen
Audit Director

State of Wisconsin
Office of the Commissioner of Insurance
Local Government Property Insurance Fund
Balance Sheet
June 30, 2000, 1999, and 1998

	June 30, 2000	June 30, 1999	June 30, 1998
Assets			
Cash and Cash Equivalents	\$ 16,519,263	\$ 5,675,058	\$ 11,180,971
Receivables:			
Due from policyholders	1,008,307	2,150,191	1,536,757
Due from State of Wisconsin	0	0	43,864
Other receivables	129,515	136,805	47,155
Reinsurance recoverable on unpaid claims (Note 5)	11,594	5,816,045	2,375,424
Total Receivables	1,149,416	8,103,041	4,003,200
Ceded Reinsurance Premiums Paid in Advance	2,215,484	966,000	0
Investments (Note 3)	11,876,176	16,015,367	12,283,259
Advance to State of Wisconsin (Note 7)	0	0	2,000,000
Total Assets	<u>\$ 31,760,339</u>	<u>\$ 30,759,466</u>	<u>\$ 29,467,430</u>
Liabilities and Retained Earnings			
Unpaid Loss Liabilities (Note 4)	\$3,423,479	\$4,443,547	\$4,362,800
Deferred Revenue for Unearned Premiums	4,526,272	4,307,029	4,355,037
Accounts Payable and Other Accrued Liabilities	427,423	455,302	156,386
Due to State of Wisconsin	2,151	3,103	6,326
Total Liabilities	8,379,325	9,208,981	8,880,549
Retained Earnings	23,381,014	21,550,485	20,586,881
Total Liabilities and Retained Earnings	<u>\$ 31,760,339</u>	<u>\$ 30,759,466</u>	<u>\$ 29,467,430</u>

The accompanying notes are an integral part of this statement.

State of Wisconsin
Office of the Commissioner of Insurance
Local Government Property Insurance Fund
Statement of Revenues, Expenses, and Changes in Retained Earnings
for the Years Ended June 30, 2000, 1999, and 1998

	Year Ended June 30, 2000	Year Ended June 30, 1999	Year Ended June 30, 1998
Operating Revenues			
Net Premiums Earned	\$ 9,367,310	\$ 9,097,812	\$ 7,915,909
Investment Income	1,379,050	1,210,501	1,274,428
Interest on Advance to State of Wisconsin	0	64,270	176,260
Total Operating Revenues	<u>10,746,360</u>	<u>10,372,583</u>	<u>9,366,597</u>
Operating Expenses			
Losses and Loss Expenses	7,872,577	8,392,766	7,105,526
Contracted Services	734,828	815,251	494,690
Personnel Services	60,692	60,726	60,729
Other Expenses	247,734	140,236	161,810
Total Operating Expenses	<u>8,915,831</u>	<u>9,408,979</u>	<u>7,822,755</u>
Net Income	<u>1,830,529</u>	<u>963,604</u>	<u>1,543,842</u>
Beginning Retained Earnings, as Previously Reported	21,550,485	20,586,881	19,174,694
Prior-Period Adjustment (Note 9)	0	0	(131,655)
Beginning Retained Earnings, as Restated	<u>21,550,485</u>	<u>20,586,881</u>	<u>19,043,039</u>
Retained Earnings, End of Year	<u>\$ 23,381,014</u>	<u>\$ 21,550,485</u>	<u>\$ 20,586,881</u>

The accompanying notes are an integral part of this statement.

State of Wisconsin
Office of the Commissioner of Insurance
Local Government Property Insurance Fund
Statement of Cash Flows
for the Years Ended June 30, 2000, 1999, and 1998

	Year Ended June 30, 2000	Year Ended June 30, 1999	Year Ended June 30, 1998
Cash Flows from Operating Activities			
Cash Received for Premiums	\$ 9,510,808	\$ 7,527,589	\$ 9,470,602
Losses and Loss Expenses Paid	(3,088,194)	(11,752,639)	(5,894,674)
Cash Payments for Contracted Services	(781,256)	(434,523)	(494,690)
Cash Payments to Employee for Services	(60,692)	(60,726)	(60,729)
Interest Received on Advance to State of Wisconsin	0	108,134	219,482
Other Operating Revenues (Expenses)	(254,701)	(372,142)	(58,732)
Net Cash Provided (Used) by Operating Activities	<u>5,325,965</u>	<u>(4,984,307)</u>	<u>3,181,259</u>
Cash Flow from Financing Activities			
Cash Received from State of Wisconsin - Repayment of Advance	<u>0</u>	<u>2,000,000</u>	<u>2,000,000</u>
Net Cash Provided by Financing Activities	<u>0</u>	<u>2,000,000</u>	<u>2,000,000</u>
Cash Flow from Investing Activities			
Proceeds from Sale and Maturities of Investments	5,963,752	3,020,568	276,153
Investment Income Received	1,531,058	1,369,298	1,190,887
Purchase of Investments	(1,976,570)	(6,911,472)	(12,133,875)
Net Cash Provided (Used) by Investing Activities	<u>5,518,240</u>	<u>(2,521,606)</u>	<u>(10,666,835)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	10,844,205	(5,505,913)	(5,485,576)
Cash and Cash Equivalents at the Beginning of the Year (as restated per Note 9)	<u>5,675,058</u>	<u>11,180,971</u>	<u>16,666,547</u>
Cash and Cash Equivalents at the End of the Year	<u>\$ 16,519,263</u>	<u>\$ 5,675,058</u>	<u>\$ 11,180,971</u>

The accompanying notes are an integral part of this statement.

State of Wisconsin
Office of the Commissioner of Insurance
Local Government Property Insurance Fund
Statement of Cash Flows
for Years Ended June 30, 2000, 1999, and 1998

Reconciliation of Net Operating Income to Net Cash and Cash Equivalents Provided by Operating Activities

	Year Ended June 30, 2000	Year Ended June 30, 1999	Year Ended June 30, 1998
Net Income	\$ 1,830,529	\$ 963,604	\$ 1,543,842
Provided by Operating Activities:			
Operating income (investment income) classified as investing activity	(1,379,050)	(1,210,501)	(1,274,427)
Changes in assets and liabilities:			
Decrease (Increase) in due from policyholders	1,141,884	(613,434)	242,582
Decrease (Increase) in due from State of Wisconsin	0	43,864	43,222
Decrease (Increase) in other receivables	7,291	(89,650)	7,289
Decrease (Increase) in reinsurance recoverable	5,804,451	(3,440,621)	83,715
Decrease (Increase) in ceded reinsurance premiums paid in advance	(1,249,484)	(966,000)	0
Increase (Decrease) in accounts payable and other accrued liabilities	(27,879)	298,915	104,886
Increase (Decrease) in deferred revenue for unearned premiums	219,243	(48,008)	1,312,111
Increase (Decrease) in unpaid loss liabilities	(1,020,068)	80,747	(1,808)
Increase (Decrease) in due to State of Wisconsin	(952)	(3,223)	1,119,847
Total Adjustments	<u>3,495,436</u>	<u>(5,947,911)</u>	<u>1,637,417</u>
Net Cash and Cash Equivalents Provided (Used) by Operating Activities	<u>\$ 5,325,965</u>	<u>\$ (4,984,307)</u>	<u>\$ 3,181,259</u>
Noncash Investing, Capital, and Financing Activities:			
Net change in unrealized gains and losses	(\$88,860)	(\$89,402)	\$115,723

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

1. Description of the Fund

The Local Government Property Insurance Fund is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's Comprehensive Annual Financial Report. The purpose of the Local Government Property Insurance Fund is to provide property insurance coverage to tax-supported local units of government such as counties, towns, cities, villages, school districts, and library boards. Coverage is available on an optional basis.

The Local Government Property Insurance Fund grew out of the State Property Insurance Fund, which was created in 1903. Chapter 221, Laws of 1979, transferred coverage for state-owned property from the State Property Insurance Fund to a self-funded program administered by the Wisconsin Department of Administration. The Fund was re-created as the Local Government Property Insurance Fund to insure the remaining nonstate government properties previously covered by the State Property Insurance Fund.

The Property Fund provides insurance coverage to local units of government against all property losses except flood, earthquake, wear and tear, extremes in temperature, war, nuclear reaction, and embezzlement. Motor vehicle and inland marine property coverage are also available.

The Property Fund functions similar to a commercial insurer. Policyholders receive insurance protection for an insurance premium. The Fund bears the risk of loss for property covered by the policies, subject to a small policy deductible that varies from \$100 to \$25,000 per claim. Policyholders are not subject to any premium assessments should a premium deficiency exist. For this and other reasons, the Fund surplus position is maintained at a sufficient level to minimize the potential for a premium deficiency to develop. Policyholders are obligated to pay the annual insurance premium and to report losses in a timely manner.

Participation in the Property Fund, along with total insurance in force for the three fiscal years, can be seen in the table that follows.

	<u>June 30, 2000</u>	<u>June 30, 1999</u>	<u>June 30, 1998</u>
Counties	71	70	70
School Districts	282	277	291
Cities	137	137	138
Towns	308	329	319
Villages	203	206	211
Miscellaneous	<u>112</u>	<u>108</u>	<u>109</u>
Total	1,113	1,127	1,138
Insurance in force	\$25,079,835,744	\$22,767,571,945	\$21,479,736,795

2. Summary of Significant Accounting Policies

- A. Basis of Presentation - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) for governments as prescribed by the Government Accounting Standards Board (GASB).
- B. Basis of Accounting - The accompanying financial statements were prepared based upon the flow of economic resources measurement focus and a full accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Financial Accounting Standards Board (FASB) statements effective after November 30, 1989, are not applied in accounting for the operations of the Property Fund.
- C. Accounting Estimates - The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results differ from those estimates. Estimates that are particularly susceptible to significant change in the near term are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 2G on unpaid loss and loss liabilities.
- D. Cash and Cash Equivalents - Cash and cash equivalents reported on the balance sheet and the statement of cash flows include cash deposited with the State of Wisconsin Treasurer, where available balances beyond immediate needs are pooled in the State Investment Fund for short-term investment purposes. The State Investment Fund is a short-term pool of State and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees. Balances pooled are restricted to legally stipulated investments. The State Investment Fund is not registered with the Securities Exchange Commission as an investment company.

Pool shares of the State Investment Fund are bought and redeemed at \$1.00 based on the amortized cost of the investments in the Fund. Income calculations are based on amortized cost of average pool balances. Shares in the State Investment Fund are reported at fair value consistent with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Investments and for External Investment Pools*.

- E. Investment Valuation - Investments of the Fund consist of high-grade fixed-income securities managed by the State of Wisconsin Investment Board. Fixed-income obligations are reported at fair value consistent with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. When available, fair value information is determined using quoted market prices. However, when quoted market prices for certain securities are not available, fair values are estimated.
- F. Premiums - Premiums are recognized as revenue over the terms of the insurance policies by calculating the earned premium on each policy. Unearned premiums are reported as deferred revenue and represent the daily pro rata portion of premiums written that are applicable to the unexpired terms of insurance policies in force. Policies are generally written for annual terms.
- G. Unpaid Loss Liabilities - The Property Fund establishes the liability for unpaid losses and loss adjustment expenses based on estimates of the ultimate cost of claims and costs associated with settling claims 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 reinsurance recoverable on unpaid claims are deducted from the liability for losses. The liability for losses is not discounted to present value.

While management believes that the liabilities for unpaid losses and unpaid loss adjustment expenses are adequate to cover the ultimate net cost of all incurred losses at year-end, the liabilities are estimates and no representation is made that the ultimate liability may not exceed such estimates. Loss liabilities are recomputed periodically to produce current estimates that reflect recent settlements, claim frequency, and other economic factors. A provision for inflation in the calculation of estimated future claims cost 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. Changes in estimates of claims costs resulting from the review process and differences between estimates and payments for claims are charged or credited to expenses in the period in which the estimates are changed or payments are made.

- H. Policy Acquisition Costs - Since the Property Fund has no marketing staff and incurs no sales commissions, acquisition costs are minimal and charged to operations as incurred.
- I. Premium Deficiency - Investment income is considered in determining whether a premium deficiency exists. No premium deficiency existed at June 30, 2000, 1999, or 1998.

3. Deposits and Investments

- A. Deposits - All cash is deposited with the State of Wisconsin Treasurer and is invested by the State of Wisconsin Investment Board through the State Investment Fund. Sections 25.17(3)(b), (ba), and (bd), Wis. Stats., enumerate the various types of securities in which the State Investment Fund may invest and include direct obligations of the United States and Canada, securities guaranteed by the United States, securities of federally chartered corporations, unsecured notes of financial and industrial issuers, Yankee/Eurodollar issues, certificates of deposit issued by banks in the United States and solvent financial institutions in the state, and bankers acceptances. The Board of Trustees of the State of Wisconsin Investment Board may approve other prudent investments. The Board of Trustees has given standing authority to the Investment Board to invest in resale agreements, financial futures contracts, options, and interest rate swaps on behalf of the State Investment Fund.

The fair value of shares in the State Investment Fund was \$16,514,927 (net of negative mark-to-market of \$57,738) as of June 30, 2000; \$5,622,613 (net of negative mark-to-market of \$32,057) as of June 30, 1999; and \$11,180,971 (net of negative mark-to-market of \$73,767) as of June 30, 1998. Shares in the State Investment Fund are not required to be categorized by risk level under GASB Statement No. 3.

- B. Investments - As directed by s. 25.17(1)(jm), Wis. Stats, all of the Property Fund's investments also are managed by the Investment Board, with the investment objectives to invest monies held in the Fund in a high-quality fixed-income obligation portfolio that provides for a high degree of liquidity, a relatively moderate degree of risk, and a high rate of return consistent with the priorities of liquidity and protection of principal. Fixed-income obligations purchased for the Property Fund consist of U.S. government obligations, financial institution obligations, and industrial obligations.

All the Property Fund's fixed-income obligations required to be categorized by GASB Statement No. 3 meet the criteria for risk category 1. Investments in risk category 1 are insured or registered, or are held by the

State or its agent in the State's name. The amortized cost and fair values of the Fund's fixed-income obligations at year-end are as follows:

<u>FY 1999-2000</u>		<u>FY 1998-99</u>		<u>FY 1997-98</u>	
<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
\$11,938,715	\$11,876,176	\$15,989,046	\$16,015,367	\$12,167,537	\$12,283,259

4. Unpaid Loss Liabilities

The Property Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related loss adjustment expenses. The following schedule represents changes in those aggregate liabilities for the Property Fund during the past three fiscal years.

	<u>FY 1999-2000</u> (in thousands)	<u>FY 1998-99</u> (in thousands)	<u>FY 1997-98</u> (in thousands)
Unpaid loss liabilities at the beginning of year	\$10,875	\$11,050	\$ 4,298
Less: reinsurance recoverable	<u>(6,431)</u>	<u>(6,687)</u>	<u>(1,055)</u>
Net unpaid loss liabilities at the beginning of year	<u>4,444</u>	<u>4,363</u>	<u>3,243</u>
Incurred losses and loss adjustment expenses:			
Provision for insured events of the current year	8,253	8,484	8,396
Increase (decrease) in provision for insured events of prior years	<u>(380)</u>	<u>(91)</u>	<u>(1,291)</u>
Total incurred losses and loss adjustment expenses	<u>7,873</u>	<u>8,393</u>	<u>7,105</u>
Payments*:			
Losses and loss adjustment expenses attributable to insured events of the current year	4,867	4,274	4,634
Losses and loss adjustment expenses attributable to insured events of prior years	<u>4,027</u>	<u>4,037</u>	<u>1,352</u>
Total payments	<u>8,894</u>	<u>8,311</u>	<u>5,986</u>
Unpaid loss liabilities at end of year	3,423	4,444	4,363
Plus: reinsurance coverage	<u>8,467</u>	<u>6,431</u>	<u>6,687</u>
Total loss liabilities at end of year	<u>\$11,890</u>	<u>\$10,875</u>	<u>\$11,050</u>

* Payments include the change in reinsurance recoverable on paid losses and drafts outstanding of \$5,804,451 in FY 1999-2000; \$3,440,621 in FY 1998-99; and (\$130,870) in FY 1997-98.

5. Reinsurance

The Property Fund purchases excess-of-loss reinsurance 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 Property Fund as direct insurer of the risks reinsured. The Property Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers.

The provisions of the reinsurance agreement provide a \$200 million limit and a \$500,000 deductible per each loss occurrence (including a 72-hour catastrophe occurrence for wind and hail exposure) for all three fiscal years. The agreement also provides a \$6.0 million annual aggregate retention in which reinsurers pay claims, less a per claim retention of \$10,000, once the Fund has incurred \$6.0 million of claims in aggregate, with respect to occurrences during the term of the agreement. Due to a change in the reinsurance term to coincide with the Fund’s fiscal year, a short-period reinsurance contract was implemented for the period December 1, 1997 through June 30, 1998, with a prorated aggregate retention for the seven-month period of \$3.5 million.

Premiums ceded to reinsurers decrease charges for earned premiums on the statement of revenues, expenses, and changes in retained earnings. Premiums ceded for reinsurance were: \$1,055,074 in FY 1999-2000; \$1,023,219 in FY 1998-99; and \$1,875,304 in FY 1997-98.

Reinsurance loss and loss adjustment expense recoveries earned for the year decrease losses and loss expenses on the statement of revenues and expenses and changes in retained earnings. Unpaid reinsurance recoverable on paid losses is included in other receivables, and unpaid reinsurance recoverable on unpaid losses and loss expenses decrease unpaid loss liabilities. Reinsurance recoveries and unsecured aggregate recoverables are:

<u>As of and for Year Ended</u>	<u>Reinsurance Recoveries Earned</u>	<u>Estimated Reinsurance Recoverable— Paid Claims</u>	<u>Estimated Reinsurance Recoverable— Unpaid Claims</u>
June 30, 2000	\$5,856,128	\$11,594	\$8,467,726
June 30, 1999	5,423,057	5,816,045	6,430,801
June 30, 1998	7,957,396	2,375,424	6,687,350

6. Pension Plan

The permanent, full-time employee of the Property Fund is a participant in the Wisconsin Retirement System (WRS), a cost-sharing, multiple-employer, defined benefit plan governed by Chapter 40 of Wisconsin Statutes. State and local

government public employees are entitled to an annual formula retirement benefit based on: 1) the employees' final average earnings; 2) years of creditable service; and 3) a formula factor. If an employee's contributions, matching employer's contributions, and interest credited to the employee's account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit.

WRS is considered part of the State of Wisconsin's financial reporting entity. Copies of the separately issued financial report that includes financial statements and required supplementary information for the year ending December 31, 1999, may be obtained by writing to:

Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931

Generally, the State's policy is to fund retirement contributions on a level-percentage-of-payroll basis to meet normal and prior service costs of the WRS. Prior service costs are amortized over 40 years, beginning January 1, 1990. The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee's classification, plus employer contributions at a rate determined annually. The relative position of the Property Fund in WRS is not available since WRS is a statewide, multiple-employer plan.

7. Loan to State of Wisconsin

According to 1991 Wisconsin Act 269, "On or before June 30, 1992, the Property Fund shall make a loan of \$10 million to the general fund. Interest shall accrue on the principal balance at the average rate earned by the State on its deposits in public depositories during the period of the loan. The general fund shall repay the loan in five annual installments of \$2 million principal plus accrued interest, beginning on or before June 30, 1994." 1993 Wisconsin Act 16 amended s. 605.35, Wis. Stats., so that loan repayments began on or before June 30, 1995, rather than on or before June 30, 1994. The \$10 million was transferred to the general fund on August 31, 1992.

The final principal installment of \$2 million was repaid on February 3, 1999. Interest earned was \$64,270 in FY 1998-99 and \$176,260 in FY 1997-98.

8. Statutory Reporting

Similar to private insurance companies doing business in Wisconsin, the Property Fund files an annual financial statement with OCI. Such statements are prepared in conformity with statutory accounting practices prescribed or

permitted by OCI. Statutory accounting practices differ from GAAP, which is the basis used to present financial statements included in this report, and follow a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations and general administrative rules.

The differences between the statutory and GAAP fund balance and net income in the table below is a result of recording investments and cash equivalents at market value under GAAP and at cost or amortized cost under statutory accounting.

<u>Fiscal Year</u>	<u>Fund Balance</u>		<u>Net Income</u>	
	<u>Statutory</u>	<u>GAAP</u>	<u>Statutory</u>	<u>GAAP</u>
1997-98	\$20,544,926	\$20,586,881	\$1,370,232	\$1,543,842
1998-99	21,556,221	21,550,485	1,011,295	963,604
1999-2000	23,501,292	23,381,014	1,945,071	\$1,830,529

9. Prior-Period Adjustment

The Property Fund implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, during the fiscal year ending June 30, 1998. This standard requires that governmental entities report investments at fair value in their balance sheets and include changes in fair value in investment income. The retained earnings balance for FY 1996-97 has been restated as follows:

Retained earnings on June 30, 1997, as previously reported	\$19,174,694
Reduction of State Investment Fund shares, investments, and retained earnings resulting from implementation of GASB Statement No. 31	<u>(131,655)</u>
Retained earnings on June 30, 1997, as restated	\$19,043,039

Ten-Year Claims Development Information

The table on page 22 illustrates how the Property Fund's earned revenues (net of reinsurance) compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Property Fund as of the end of each of the last ten years. The rows of the table are defined as follows:

1. Premiums and investment revenue—shows total fiscal-year gross earned premium revenue and reported investment revenue, amount of reinsurance premium ceded, and amount of net earned revenues.
2. Unallocated expenses—shows each fiscal year's other operating costs, including overhead and claims expenses not allocable to individual claims.
3. Estimated incurred claims and expenses as of end of policy year—shows gross incurred claim and allocated claim adjustment expenses (both paid and accrued), losses assumed by reinsurers, and total net amount of incurred claims and allocated claim adjustment expenses 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. Net paid (cumulative)—shows cumulative net amounts paid as of the end of successive years for each policy year.
5. Reestimated ceded losses and expenses—shows the reestimated amount of losses and expenses assumed by reinsurers as of the end of the current fiscal year for each policy year.
6. Reestimated net incurred claims and expenses—shows the development of each policy year's incurred losses as of the end of successive years. The annual reestimated amounts result from new information received on known claims and reevaluation of existing information on known claims, as well as emergence of new claims not previously known.
7. Increase/decrease in estimated incurred claims and expenses—compares the most recent reestimation for net incurred loss amount to the amount originally established (line 3). As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred losses currently recognized in less-mature policy years.

**State of Wisconsin
Office of the Commissioner of Insurance
Local Government Property Insurance Fund
Ten-Year Claims Development Information**

Fiscal Policy Year Ended June 30
(in thousands)

	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
1. Premiums and Investment Revenue:										
Earned	\$ 9,204	\$ 8,986	\$ 9,315	\$ 9,665	\$ 9,982	\$10,347	\$10,633	\$11,241	\$11,396	\$11,801
Ceded	<u>1,816</u>	<u>1,590</u>	<u>1,776</u>	<u>1,789</u>	<u>1,460</u>	<u>1,359</u>	<u>1,678</u>	<u>1,875</u>	<u>1,023</u>	<u>1,055</u>
Net earned	7,388	7,396	7,539	7,876	8,522	8,988	8,955	9,366	10,373	10,746
2. Unallocated Expenses	94	72	20	50	26	46	73	113	68	115
3. Estimated Incurred Claims and Expenses, End of Policy Year:										
Incurred	4,621	4,693	6,965	8,055	4,427	9,402	8,431	16,828	12,543	16,134
Ceded	-	664	480	2,300	-	1,600	1,328	8,515	4,127	7,881
Net Incurred	4,621	4,029	6,485	5,755	4,427	7,802	7,103	8,313	8,416	8,253
4. Net Paid (Cumulative) as of:										
End of policy year	2,165	2,189	3,282	2,805	2,489	3,376	4,005	4,561	4,206	4,866
One year later	4,032	3,378	5,957	5,377	4,493	6,956	5,880	7,979	7,452	
Two years later	3,893	3,436	6,236	5,464	4,578	6,667	6,361	8,173		
Three years later	3,898	3,441	6,248	5,766	4,578	6,763	6,385			
Four years later	3,898	3,629	6,248	5,470	4,578	6,763				
Five years later	3,898	3,629	6,248	5,470	4,578					
Six years later	3,898	3,629	6,248	5,470						
Seven years later	3,898	3,629	6,248							
Eight years later	3,898	3,629								
Nine years later	3,898									
5. Reestimated Ceded Losses and Expenses	-	893	542	4,313	-	2,150	1,020	8,339	3,653	7,881
6. Reestimated Net Incurred Claims and Expenses:										
End of policy year	4,621	4,029	6,485	5,755	4,427	7,280	7,103	8,313	8,416	8,253
One year later	4,114	3,491	6,230	5,552	4,674	7,095	6,357	8,180	7,785	
Two years later	3,895	3,443	6,246	5,534	4,578	6,801	6,393	8,620		
Three years later	3,898	3,629	6,248	5,771	4,578	6,763	6,460			
Four years later	3,898	3,629	6,248	5,570	4,578	6,763				
Five years later	3,898	3,629	6,248	5,570	4,578					
Six years later	3,898	3,629	6,248	5,570						
Seven years later	3,898	3,629	6,248							
Eight years later	3,898	3,629								
Nine years later	3,898									
7. Increase (Decrease) in Estimated Incurred Claims and Expenses from End of Policy Year	(\$723)	(\$400)	(\$237)	(\$185)	\$151	(\$1,039)	(\$643)	\$307	(\$631)	-

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

We have audited the financial statements of the State of Wisconsin Local Government Property Insurance Fund as of and for the years ended June 30, 2000, 1999, and 1998, and have issued our report thereon dated October 26, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Local Government Property Insurance Fund's financial statements are free of material misstatement, we performed tests of the Property Fund's compliance with certain provisions of laws, regulations, and contracts, 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*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Local Government Property Insurance Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Local Government Property Insurance Fund management and the Wisconsin Legislature's Joint Legislative Audit Committee. This restriction is not intended to limit the distribution of this report, which, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its

distribution is not limited. However, because we do not express an opinion on compliance or provide assurance on internal control over financial reporting, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

October 26, 2000

by

Diann Allsen
Audit Director