Report 16-4
March 2016

Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

STATE OF WISCONSIN

Legislative Audit Bureau

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CONTENTS

STATE OF WISCONSIN
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Joe Chrisman
State Auditor

March 10, 2016

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1) (de), Wis. Stats., we have completed a financial audit of the Injured Patients and Families Compensation Fund, which insures health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. The Fund is overseen by a Board of Governors and administered by the Office of the Commissioner of Insurance (OCI). We have provided an unmodified opinion on the Fund's financial statements as of and for the years ended June 30, 2015, June 30, 2014, and June 30, 2013.

The Fund's net position increased significantly during our audit period from $445.0 million as of July 1, 2012, to $733.9 million as of June 30, 2015. This increase was due, in part, to reductions in the actuarial estimates for loss liabilities and improvements in the investment markets. As we recommended in report 13-4, OCI worked with the Board of Governors and the Fund's actuary to establish a target range for the Fund's net position, which the actuary recommended in October 2015 should be between approximately $86.4 million and $376.6 million. As of September 30, 2015, the Fund's unaudited net position was $783.0 million, which was $406.4 million above the targeted maximum net position. We recommend OCI continue to work with the Board of Governors to monitor the Fund's net position and develop a plan to bring the net position within the target range established by the Board of Governors.

Board of Governors policy requires that an actuarial audit be performed every three years. However, the most recent actuarial audit was completed in December 2011. It is important that timely and regular actuarial audits are completed by an independent actuary because the independent actuary may recommend improvements to the actuarial estimates. An actuarial audit could also include a review of the recommended target range for the Fund's net position. We recommend OCI comply with the Board of Governors policy, ensure the actuarial audit includes a review of the recommended target range for the Fund's net position, and report to the Joint Legislative Audit Committee on the status of the actuarial audit by September 30, 2016.

We appreciate the courtesy and cooperation extended to us by the staff of OCI and the Fund's contractors. A response from OCI follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/BN/ss

Introduction ■

2003 Wisconsin Act 111 established the Fund as an irrevocable trust for the sole benefit of participating health care providers and claimants.

The Injured Patients and Families Compensation Fund insures participating physicians and other health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. The Fund was created as the Patients Compensation Fund in Chapter 37, Laws of 1975, in response to concerns over the cost and availability of medical malpractice insurance. 2003 Wisconsin Act 111 changed the Fund's name to the Injured Patients and Families Compensation Fund and established it as an irrevocable trust for the sole benefit of health care providers participating in the Fund and claimants. Wisconsin is one of at least 13 states with active compensation funds for patients, although the structure of each fund varies by state.

Most health care providers in Wisconsin are required to purchase secondary medical malpractice insurance from the Fund.

Statutes require most health care providers that operate or have permanent practices in Wisconsin to maintain primary medical malpractice coverage of $1.0 million for each incident and $3.0 million per policy year. Statutes also require participation in the Fund, which provides unlimited secondary medical malpractice coverage for economic damages that exceed the primary medical malpractice coverage.

The Fund insures individual health care providers, such as physicians and nurse anesthetists; institutions, such as hospitals, ambulatory surgery centers, and certain nursing homes; entities, such as medical partnerships, corporations, and cooperatives; and other entities that are owned or controlled by hospitals. Certain providers are statutorily exempt from participation in the Fund, including public employees and those providing services for less than 241 hours a year. As of June 30, 2015, 16,140 individual providers, institutions, and other entities participated in the Fund.

The Fund, which is administered by the Office of the Commissioner of Insurance (OCI), is governed by a 13-member Board of Governors chaired by the Commissioner of Insurance. The Commissioner has statutory responsibility for administering the Fund. During the three-year audit period, OCI contracted with Wausau MedMal Management Services, LLC for claims administration; Pinnacle Actuarial Resources, Inc., for actuarial services; and Marsh USA, Inc., for risk management services.

The Fund's investments are managed by the State of Wisconsin Investment Board (SWIB), which currently contracts with an external investment manager to oversee the Fund's investment portfolio. Investments include fixed income securities and, as allowed by the investment policy, up to 20.0 percent in equity securities. The Fund's cash balances are accounted for in the State Investment Fund, which is a short-term pool of state and local funds managed by SWIB.

Statutes require the Legislative Audit Bureau to perform a financial audit of the Injured Patients and Families Compensation Fund at least once every three years. In completing our audit, we reviewed the Fund's internal controls; assessed the fair presentation of its financial statements as of and for the years ended June 30, 2015, June 30, 2014, and June 30, 2013; and reviewed compliance with certain statutory provisions. We also reviewed the financial status of the Fund and followed up on prior audit recommendations.

Annual Assessments

Assessment rates vary by provider type and specialty area.

Participating providers pay annual assessments based on their type and specialty area. For example, among individual providers, assessment rates are higher for physicians than for nurses, and are higher for physicians who perform surgery than for those who do not. Physicians were assessed rates for fiscal year (FY) 2014-15 coverage that ranged from $1,311 for general practice physicians to $8,653 for obstetric and neurological surgeons.

In consultation with the Fund's actuary, and within established statutory limits, the Board of Governors attempts to match annual assessments with the ultimate claims that are associated with events that occurred during the period of insurance coverage. In establishing assessment rates, the Board also considers the Fund's financial position, its cash flow needs, and Wisconsin's medical malpractice environment. In an effort to reduce the balance in the Fund, the Board has decreased assessment rates over the last several years, as shown in Table 1.

Table 1

Assessment Rates and Revenues

Policy Year	Percentage Change in Provider Assessment Rates	Assessment Revenues
FY 2011-12	8.5%	$36,371,756
FY 2012-13	5.0	38,585,018
FY 2013-14	(5.0)	36,564,407
FY 2014-15	(10.0)	33,735,169
FY 2015-16	(34.0)	23,100,000[1]

[1] Estimated.

Claim Payments

There is no limit to the compensation the Fund will pay on behalf of participating providers for economic damages, such as medical costs and loss of income. If the Fund does not have sufficient funds to pay the claims, Wisconsin Statutes allow up to $100.0 million to be supplemented by general purpose revenue. Awards of noneconomic damages in medical malpractice claims, which include compensation for suffering, mental distress, and loss of companionship and affection, have been limited by Wisconsin Statutes to $750,000 since April 6, 2006. The limit was enacted after a 2005 Wisconsin Supreme Court ruling found a $350,000 inflation-adjusted limit on noneconomic damages in medical malpractice cases to be an unconstitutional violation of equal protection guarantees in the Wisconsin Constitution. Because of the Court’s 2005 decision, there are currently no limits on the recovery of noneconomic damages for incidents that occurred on or prior to April 5, 2006.

The Fund has paid $855.3 million for 672 claims from its inception through June 30, 2015.

The Fund has paid $855.3 million for 672 claims from its inception in 1975 through June 30, 2015. Individual claim payments have ranged from $4,000 to $34.3 million. As shown in Table 2, 71.4 percent of paid claims have been for amounts less than $1.0 million. However, these 480 paid claims account for only 19.0 percent of the Fund’s total payments for all claims through June 30, 2015. In contrast, 41 claims with payments of $5.0 million or more represent 44.3 percent of the total claim payments over that time period.

Table 2

Paid Claims from the Fund's Inception through June 30, 2015

Claim Amount	Number of Paid Claims	Percentage of Paid Claims	Amount Paid for All Claims	Percentage of Total Payments for All Claims
$5.0 Million or More	41	6.1%	$379,306,901	44.3%
At Least $1.0 Million but Less Than $5.0 Million	151	22.5	313,370,687	36.7
Less Than $1.0 Million	480	71.4	162,625,268	19.0
Total	**672**	**100.0%**	**$855,302,856**	**100.0%**

As shown in Table 3, the Fund made claim payments of $10.0 million or more for ten claims through June 30, 2015. The two largest claim payments were for incidents that occurred prior to April 2006, and included significant noneconomic damage awards that were not subject to any limit. The largest noneconomic damages award was $11.5 million, which was included as part of a $34.3 million claim paid in FY 2007-08.

Table 3

Claim Payments of $10 Million or More through June 30, 2015
(in millions)

Fiscal Year of Incident	Fiscal Year of Payment	Claimant Allegations	Economic Damages	Noneconomic Damages	Total[1]
2003-04	2007-08	Negligent blood transfusion caused cardiac arrest and brain damage.	$22.8	$11.5	$34.3
2004-05	2010-11	Negligent labor and delivery caused brain damage.	11.0	11.0	22.0
1985-86	1992-93	Diet pills prescribed without a complete physical evaluation caused cardiac arrest and brain damage.	9.0	9.0	18.0
2006-07	2008-09	Improperly performed surgical procedure caused brain damage.	–[2]	–[2]	16.3
1993-94	1996-97	Negligent treatment caused quadriplegia.	–[2]	–[2]	15.6
1993-94	2000-01	Initial surgery and follow-up treatments of pinched nerve were negligent, which caused continuing pain.	4.3	9.3	13.6
2000-01	2012-13	Negligent delivery caused brain damage.	8.9	3.1	12.0
2003-04	2006-07	Negligent delivery caused brain damage.	11.0	0.0	11.0
1996-97	2005-06	Negligent treatment caused brain damage.	9.1	1.0	10.1
2001-02	2006-07	Negligent labor and delivery caused brain damage.	–[2]	–[2]	10.0

[1] Includes interest on losses paid and amounts deposited into future medical expense accounts.

[2] The claim payment was based on a settlement in which the economic and noneconomic damage amounts were not specified.

A small number of large-value claims can significantly affect the Fund's operations and cash flow. Both the uncertainty and long-term nature of medical malpractice claims make it difficult to predict if or when large claims will be settled and paid from the Fund. As a result, total annual claim payments can fluctuate from year to year and sufficient reserves need to be set aside to ensure funds are available to pay these claims.

Estimating loss liabilities is challenging because of the unlimited and long-term nature of the Fund's medical malpractice claims.

To estimate the amount of reserves that needs to be set aside to pay potential claims, the Fund uses an actuary to project the estimated loss liabilities that may be required to pay for medical malpractice incidents that have occurred but may not yet have been settled or even reported. The estimated loss liabilities include an additional risk margin of 25.0 percent to account for the uncertainties related to the estimates. The Board of Governors relies on the Fund's actuary to help estimate loss liabilities. However, accurately estimating the Fund's loss liabilities is challenging because:

- secondary medical malpractice insurance claims typically are infrequent and involve severe cases;
- a medical malpractice claim may be filed years after an incident occurred;
- there is no limit on the amount of economic losses the Fund may be required to pay;
- legislation and court decisions can significantly affect the Fund's liabilities; and
- the methodology and assumptions used by an actuary can significantly affect the result of an analysis.

The Fund's estimated loss liabilities as of June 30, 2015, were $486.0 million.

The Fund's actuary reviews and revises total loss liability estimates each year, based on an additional year of claims experience and other information. Because the actual claims experience has been more favorable than originally expected, over the past several years, the actuary has regularly reduced the estimate of the Fund's loss liabilities, as shown in Table 4. For example, in estimating the loss liabilities as of June 30, 2015, the Fund's actuary reduced the loss liabilities by $110.5 million, resulting in reported estimated loss liabilities totaling $486.0 million to cover future claim payments. Because of the significant uncertainties, the actuarial estimates are further emphasized in our unmodified audit opinion on the Fund's financial statements.

Table 4

Total Loss Liabilities
As of June 30
(in millions)

Year	Total Loss Liabilities	Percentage Change
2010	$721.1	–
2011	636.5	(11.7)%
2012	665.8	4.6
2013	628.0	(5.7)
2014	596.5	(5.0)
2015	486.0	(18.5)

Absent other changes, as the estimated loss liabilities are decreased, so too are the underwriting expenses, which may result in reporting a negative expense on the financial statements. For example, for FY 2014-15, total underwriting expenses were $(89.4) million, which was reported on the Statement of Revenues, Expenses, and Changes in Fund Net Position. Negative underwriting expenses were also reported for FY 2013-14 and FY 2012-13.

Financial Status of the Fund

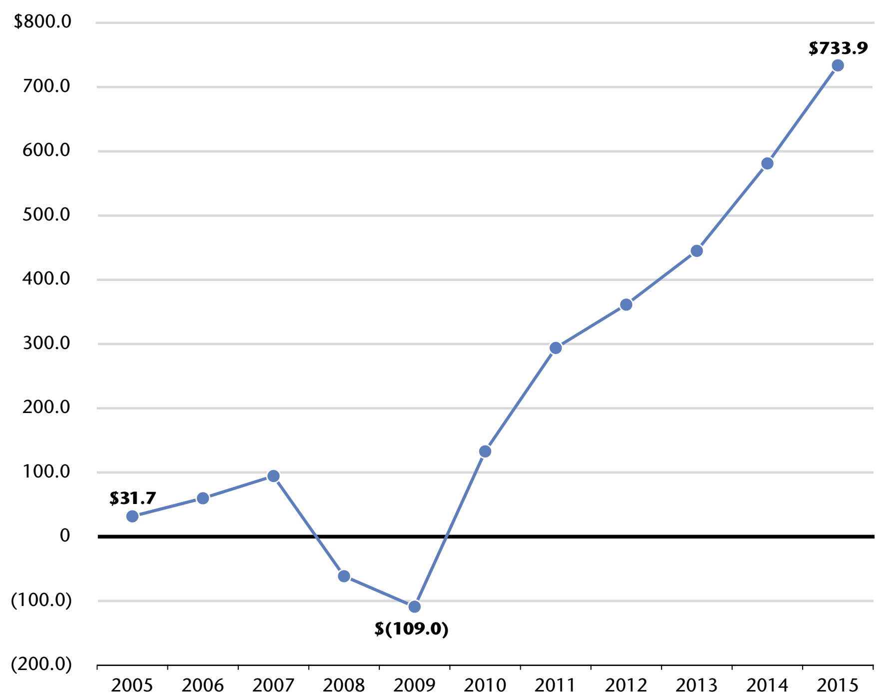
In any insurance operation, a positive financial position is important to ensure adequate resources are available to pay unexpected claims. The uncertainties associated with the long-term nature of the Fund as a secondary medical malpractice insurer increase the importance of maintaining a positive financial position. Although their interests and priorities differ, health care providers, users of health care services, and attorneys in malpractice cases all benefit by having confidence in the reliability and soundness of the Fund's financial operations.

The Fund had a net position of $733.9 million as of June 30, 2015.

The Fund's financial position is represented by its net position. A positive net position indicates that sufficient assets have been set aside to fully fund the estimated loss liabilities and other liabilities. As shown in Figure 1, from FY 2004-05 through FY 2006-07, the net position remained relatively constant, increasing slightly to $94.4 million as of June 30, 2007. The balance declined in FY 2007-08 and FY 2008-09 due to a $200.0 million transfer out of the Fund and a decline in the investment markets. However, the transfer was repaid and the net position increased during FY 2009-10. The net position continued to significantly increase and was $733.9 million as of June 30, 2015.

Figure 1

Net Position
As of June 30
(in millions)



Investment income helps reduce the provider assessments needed to pay current and future claims. In fact, investment income exceeded the amount of total underwriting expenses in each year from FY 2009-10 through FY 2014-15.

The Fund's financial position is also significantly affected by changes in its estimated loss liabilities. As noted, the Fund's estimated total loss liabilities declined from $721.1 million as of June 30, 2010, to $486.0 million as of June 30, 2015. A decrease in estimated loss liabilities has had the effect of increasing the Fund's net position. As noted, the net position has increased from $132.8 million as of June 30, 2010, to $733.9 million as of June 30, 2015.

Although the Fund's actuary estimates the loss liabilities based on, among other factors, past claims experience for the Fund, future court decisions may also have an effect on the financial condition of the Fund. In October 2014, a Wisconsin circuit court ruling held that the $750,000 noneconomic damage limit was unconstitutional as applied in *Mayo v. Wisconsin Injured Patients and Families Compensation Fund*. The court awarded the jury's judgment of $16.5 million in noneconomic damages. This ruling is currently being appealed to the Wisconsin Court of Appeals.

Target Net Position

In the past, the focus of the Board of Governors had been to ensure the Fund set aside sufficient assets to pay claims. However, because of the significant increase in the Fund's net position in recent years, the focus has shifted to managing the net position and determining an appropriate net position to maintain for the Fund. As noted, the net position is in addition to the assets set aside to fund the estimated loss liabilities.

The Fund's unaudited September 30, 2015, net position was $406.4 million above the targeted maximum net position.

In report 13-4, we recommended OCI work with the Board of Governors to establish a target range of minimum and maximum net position for the Fund to maintain and to establish a process to evaluate the appropriateness of the targets on an annual basis. In September 2013, and with the help of the Fund's actuary, the Board of Governors developed a policy establishing a target range for the net position using specified criteria. Based on this target range, in October 2015 the actuary recommended that the Board of Governors attempt to keep the net position between approximately $86.4 million and $376.6 million. The Fund's unaudited net position as of September 30, 2015, was $783.0 million, which was $406.4 million above the targeted maximum net position.

The Fund's revenue can be reduced by decreasing provider assessments, which the Board of Governors began to do for FY 2013-14. As noted, overall assessment rates decreased by 5.0 percent for FY 2013-14, 10.0 percent for FY 2014-15, and 34.0 percent for FY 2015-16. However, OCI staff indicated there is not statutory authority to refund money in the form of an assessment dividend to those who participate in the Fund. Because the net position was above the target range, in December 2015 the Board of Governors approved an additional 30.0 percent reduction in assessment rates for FY 2016-17.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance:

- *continue to work with the Board of Governors to monitor the Fund's net position; and*
- *develop a plan to bring the net position within the target range established by the Board of Governors.*

Prior Audit Recommendations

OCI has addressed the two recommendations we made in report 13-4. As noted, OCI worked with the Board of Governors to develop a policy establishing a target range for the net position using specified criteria. The Board of Governors developed such a policy in September 2013. In addition, the Fund established and documented clear procedures for completing and verifying the accuracy of the Fund's financial statements. Although we identified some financial reporting errors and suggested some audit adjustments, none of the reporting errors indicated a control deficiency that auditing standards would have required us to include in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters. We do note that the Fund's accountant left OCI employment in November 2015. The Fund will need to ensure that the newly hired accountant continues to verify the accuracy of the Fund's financial statements in the future.

OCI is not in compliance with a policy of the Board of Governors that requires an actuarial audit every three years.

In response to an audit recommendation in report 10-4, the Board of Governors established a policy that requires OCI to contract for an actuarial audit of the Fund every three years. As part of the actuarial audit, another actuary independent of the Fund's actuary assesses the reasonableness of the actuarial methodology and assumptions used in developing estimates of the Fund's loss liabilities. Such reviews or audits are common for critical actuarial analyses, such as those completed for the Fund. The most recent actuarial audit was completed in December 2011, and it concluded that the Fund's selected risk margin was reasonable. However, due to management oversight and staff turnover, OCI has not contracted for the next actuarial audit, even though it has been more than three years. OCI did receive simplified bids in March 2015 to review the Fund's 2014 actuarial work, but no contract was signed.

Timely and regular actuarial audits are important because the independent actuary may recommend improvements.

Timely and regular actuarial audits are important because the independent actuary may recommend further improvements to the process for estimating the Fund's loss liabilities. In addition, OCI staff agreed that it would be appropriate for the actuarial audit to include a review of the target range for the Fund's net position.

☑ Recommendation

We recommend that the Office of the Commissioner of Insurance:

- *comply with the policy of the Board of Governors to have an actuarial audit completed every three years;*
- *ensure that the actuarial audit include a review of the recommended target range for the Fund's net position; and*
- *report to the Joint Legislative Audit Committee by September 30, 2016, on the status of the actuarial audit.*

▪ ▪ ▪ ▪

Audit Opinion

STATE OF WISCONSIN
Legislative Audit Bureau
Celebrating 50 Years of Service 1966-2016
22 East Mifflin Street, Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Theodore K. Nickel, Commissioner
Office of the Commissioner of Insurance

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Injured Patients and Families Compensation Fund of the State of Wisconsin as of and for the years ended June 30, 2015, June 30, 2014, and June 30, 2013, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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*, which is issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on these financial statements.

Opinion

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Injured Patients and Families Compensation Fund as of June 30, 2015, June 30, 2014, and June 30, 2013, and the respective changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphases of Matter

As discussed in Note 5 to the financial statements, the Injured Patients and Families Compensation Fund's projected ultimate loss liabilities are estimates based on recommendations of a consulting actuary. The Injured Patients and Families Compensation Fund's Board of Governors and management believe that the estimated loss liabilities are reasonable and represent the most probable estimates of the losses the Fund will pay for the claims incurred as of the end of each fiscal year. Uncertainties inherent in projecting the frequency and severity of large secondary medical malpractice insurance claims, the Fund's unlimited liability coverage, and extended reporting and settlement periods make it likely that amounts paid will ultimately differ from the reported estimated liabilities. These differences cannot currently be quantified.

As discussed in Note 1 to the financial statements, the financial statements referred to in the first paragraph present only the Injured Patients and Families Compensation Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin as of June 30, 2015, June 30, 2014, and June 30, 2013, the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the financial statements, the Injured Patients and Families Compensation Fund implemented Governmental Accounting Standards Board Statement Number 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* which changed the format of its financial statements.

Our opinion is not modified for any of the above matters.

Other Matter

Required Supplementary Information—Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on page 19 through 27 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the

United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to do so.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated March 3, 2016, on our consideration of the Injured Patients and Families Compensation Fund's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; 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 used when considering the Injured Patients and Families Compensation Fund's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

March 3, 2016

Management's Discussion and Analysis ■

Prepared by Management of the Wisconsin Injured Patients and Families Compensation Fund

This section presents Management's Discussion and Analysis of the financial performance of the Wisconsin Injured Patients and Families Compensation Fund during the fiscal years ended June 30, 2015, June 30, 2014, and June 30, 2013. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the management of the Fund.

Overview of the Fund

The Fund, formerly known as the Patients Compensation Fund, was created in 1975 to provide excess medical malpractice insurance for Wisconsin health care providers. Under broad authority granted to it by s. 655.27 (2), Wis. Stats., the Fund is governed by a 13-member Board of Governors. The Board consists of three insurance industry representatives; a member named by the Wisconsin Academy of Trial Lawyers, which was renamed Wisconsin Association for Justice in 2007; a member named by the State Bar of Wisconsin; two members named by the Wisconsin Medical Society; a member named by the Wisconsin Hospital Association; four public members appointed by the Governor; and the Commissioner of Insurance, who serves as the chair. The Fund's administrative staff is provided by the Office of the Commissioner of Insurance.

The Board is assisted by its Actuarial and Underwriting Committee; Legal Committee; Claims Committee; Finance, Investment, and Audit Committee; Risk

Management and Patient Safety Committee; and Peer Review Council. The Board and its committees meet quarterly.

The Fund operates on a July 1 through June 30 fiscal year basis. Administrative costs and operating costs, including claim payments, are funded through assessments on participating health care providers and investment earnings.

Financial Statements

The Fund's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Financial statements for each of the past three fiscal years follow this discussion and analysis. Only significant sections of the financial statements are discussed in the following pages.

Assets

The Fund's assets consist primarily of investments, which are managed by the State of Wisconsin Investment Board in accordance with Wisconsin Statutes and the directives of the Board of Governors and its Finance, Investment, and Audit Committee. The Board has established investment guidelines to be followed by the Investment Board. Compliance with these guidelines is reviewed quarterly by the Finance, Investment, and Audit Committee.

The Fund's investment strategy is to invest at least 75.0 percent of its assets in fixed income securities that have a reasonable degree of safety of principal, as well as income-paying ability. The rest may be invested in equities or as a cash reserve with a maximum of 20.0 percent being in equities. High priority is given to matching the maturity of assets with the liquidity needs of the liabilities. Equities made up 18.3 percent of total investments as of June 30, 2015, 18.0 percent as of June 30, 2014, and 18.7 percent as of June 30, 2013. The Fund was in compliance with the investment guideline that limits equities to no more than 20.0 percent of total investments. Investments are reported at fair value.

As shown in Table A, there have been increases in total assets over the last three years. Total assets, which primarily include investments, increased from $1.0 billion as of June 30, 2012, to $1.1 billion as of June 30, 2013, to $1.2 billion as of June 30, 2014, and to over $1.2 billion as of June 30, 2015. The increases are primarily attributed to gains on investments.

Table A

Total Assets
As of June 30

Year	Total Assets	Percentage Change from Prior Year
2015	$1,224,008,967	3.6%
2014	1,181,572,739	9.4
2013	1,079,805,404	5.0
2012	1,028,483,286	–

Loss Liabilities

Loss liabilities are the amounts expected to be paid in the future for incidents that have already occurred, and they account for nearly all of the liabilities of the Fund. Total loss liabilities, which are shown in Table B, include the total of individual case estimates for reported losses, the actuarially determined estimate for losses that have been incurred but have not yet been reported to the Fund, and provisions for the estimated future payment of loss adjustment costs associated with the outstanding claims, future investment earnings, accounts managed by the Fund for future medical expenses, and contributions from the primary insurer on a current claim.

Table B

Total Loss Liabilities
As of June 30

Year	Total Loss Liabilities	Percentage Change from Prior Year
2015	$486,038,973	(18.5)%
2014	596,456,089	(5.0)
2013	627,973,859	(5.7)
2012	665,777,868	–

Changes in loss liabilities from one year to the next reflect a combination of another year's loss experience, plus or minus any change to prior years' loss liability estimates based on actuarial studies. The uncertainties inherent in projecting the frequency and severity of claims because of the Fund's unlimited liability coverage for economic damages, extended reporting and settlement periods, and the effect of court decisions and legislative initiatives make it likely that the amounts ultimately paid will differ from the reported estimated liabilities. These differences cannot be quantified. The Fund's actuary performs an annual review of the outstanding estimated liabilities for each year and makes adjustments for each year as deemed appropriate.

The loss liabilities can also be affected by the investment rate assumption and corresponding discount factor used in determining their present value, as required by Wisconsin Administrative Code. Changes in the discount factor, as well as the amount of the estimated loss liabilities and available assets, affect the contra liability account—amount representing interest—and the change in that account, which is reflected as an underwriting expense. The Board of Governors decreased the investment rate assumption from 5.0 percent to 4.5 percent effective for the loss liabilities as of June 30, 2013, which remained in effect through June 30, 2015, and increases the present value of the loss liabilities. The investment rate assumption resulted in discount factors of 0.848 for FY 2014-15, 0.848 for FY 2013-14, 0.849 for FY 2012-13.

Net Position

The Fund's net position, which is the assets plus deferred outflows less the liabilities and deferred inflows, for the past four years are shown in Table C. The changes in net position are largely attributable to the difference between revenues earned and expenses incurred, which include changes made to loss liability estimates for previous years as determined by the actuary, and unrealized investment gains and losses, which reflect changes in the fair value of held investments.

Table C

Net Position
As of June 30

Year	Net Position	Percentage Change from Prior Year
2015	$733,852,348	26.3%
2014	581,107,880	30.5
2013	445,010,671	23.2
2012	361,261,614	–

The Fund's net position increased from $361.3 million as of June 30, 2012, to $445.0 million as of June 30, 2013, or by $83.7 million. The increase in net position from June 30, 2013, to June 30, 2014, was $136.1 million and the increase from June 30, 2014, to June 30, 2015, was $152.7 million. The increase of net position for these years can be attributed to a decrease in the amount of claims paid, a decrease in the loss liabilities, and an increase in investment income.

Revenues

The Fund's revenues consist primarily of assessments and investment income. All Fund participants are billed annually in accordance with an assessment rate determined by the Board of Governors. Investment income varies for reasons that include the economy in general, the operating experience of the Fund, and the amount of new money available for investing.

As shown in Table D, total revenues decreased significantly from FY 2011-12 to FY 2012-13, primarily as a result of decline in investment income, which decreased by $36.8 million. Total revenue increased by $53.4 million in FY 2013-14 due to increased investment income as a result of improved performance of the investments. For FY 2014-15, there was a decrease in total revenues of $58.8 million. This decrease was due to a decline in assessments revenue, which is attributed to a reduction of 10.0 percent in assessment rates and a decrease in investment income caused by a fall in investment performance during that year.

Table D

Total Revenues

Fiscal Year	Total Revenues	Percentage Change from Prior Year
2014-15	$ 64,008,014	(47.8)%
2013-14	122,782,690	77.0
2012-13	69,356,196	(33.3)
2011-12	103,931,752	–

Assessment revenues, which are shown in Table E, depend on the number of each type of provider participating in the Fund and the assessment rates in effect for each provider type. The Board of Governors authorized changes in assessment rates as follows: a 5.0 percent increase for FY 2012-13, a 5.0 percent decrease for FY 2013-14, and a 10.0 percent decrease for FY 2014-15. Total assessments can fluctuate at a rate somewhat different than the approved rate change because of changes in the number and classification of providers.

Table E

Assessment Revenues

Fiscal Year	Assessment Revenues	Percentage Change from Prior Year
2014-15	$33,735,169	(7.7)%
2013-14	36,564,407	(5.2)
2012-13	38,585,018	6.1
2011-12	36,371,756	–

Physicians are classified into one of four classes based upon a risk assessment of their specialty. Hospitals are assessed based upon the number of beds and outpatient visits. As shown in Table F, as of June 30, 2015, the vast majority of Fund participants were physicians.

Table F

Providers by Type
As of June 30, 2015

Provider Type	Number of Providers	Percentage of Total Providers
Physicians	13,977	86.6%
Corporations	1,150	7.1
Nurse Anesthetists	737	4.6
Hospitals	147	0.9
Partnerships	20	0.1
Hospital-affiliated Nursing Homes	19	0.1
Hospital-owned or Hospital-controlled Entities	20	0.1
Ambulatory Surgery Centers	69	0.4
Cooperatives	1	0.0
Total	**16,140**	**100.0%**

Investment income, which includes fixed income portfolio interest, stock dividends, and investment gains and losses, is shown in Table G. The Fund earned investment income ranging from $31.9 million to $34.1 million over the four-year period from its debt securities. Annual investment income can also be significantly affected by changes in unrealized gains and losses associated with changes in the fair value of the Fund's investments, which can be affected by the Fund's experience in the equities market, changes in the ratings within the fixed income portfolio, and changes in the interest rate environment. The Fund recognized unrealized investment gains of $4.3 million in FY 2014-15, $38.8 million in FY 2013-14, and $249,200 in FY 2012-13.

Table G

Investment Income

Fiscal Year	Investment Income[1]	Percentage Change from Prior Year
2014-15	$30,200,545	(64.9)%
2013-14	86,155,806	180.3
2012-13	30,735,205	(54.5)
2011-12	67,517,498	–

Underwriting Expenses

The Fund's underwriting expenses, which are shown in Table H, consist of loss and loss adjustment expenses paid, plus changes to the liabilities for unpaid claims. The changes to the liabilities can be either positive or negative amounts, depending upon the annual actuarial analysis of the outstanding loss liabilities on a year-by-year basis.

Table H

Underwriting Expenses

Fiscal Year	Underwriting Expenses	Percentage Change from Prior Year
2014-15	$(89,359,050)	(525.9)%
2013-14	(14,277,328)	(5.8)
2012-13	(15,150,670)	(142.2)
2011-12	35,884,135	–

The major cause of the significant changes in the underwriting expenses are changes in actuarial projections related to the outstanding liabilities for unpaid losses and loss adjustment expenses. In addition, any changes to the investment rate assumption used in the discounting of the loss liabilities, such as the decrease to 4.5 percent in FY 2012-13, will flow through to the underwriting expenses.

For FY 2012-13, FY 2013-14, and FY 2014-15, the Fund reported negative underwriting expenses each year in total, because decreases to total loss liability estimates were greater than increases. The Fund reduced its loss liability estimates from prior years after an additional year of claims experience with lower claim payments. The liability includes an explicit risk margin that is established to ensure that loss liabilities will remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments.

Summary

The Wisconsin Injured Patients and Families Compensation Fund, a segregated fund administered by the Office of the Commissioner of Insurance, operates as a risk-sharing fund. Assessments are collected from participating health care providers and are used to pay underwriting and administrative expenses. The Fund's Board of Governors determines the assessment rates annually, based on actuarial advice. While the investments of the Fund currently can be used to meet current claim obligations, the Board is closely monitoring the revenues, assets, and net position of the Fund.

Investments are predominantly conservative (approximately 80.0 percent in fixed income securities and 20.0 percent in equities), with the intent to match assets with liabilities while maximizing return.

Contacting the Fund's Financial Management

This financial report is designed to provide the Legislature, the executive branch of government, the Board of Governors, the public, and other interested parties with an overview of the financial results of the Fund's activities and to show the Fund's financial position. If you have questions about this report or need additional information, contact the director of the Wisconsin Injured Patients and Families Compensation Fund at:

Office of the Commissioner of Insurance
125 South Webster Street
P.O. Box 7873
Madison, Wisconsin 53707-7873

■ ■ ■ ■

Financial Statements ■

Statement of Net Position
June 30, 2015, June 30, 2014, and June 30, 2013

	June 30, 2015	June 30, 2014	June 30, 2013
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES			
Current Assets:			
Cash and Cash Equivalents (Note 4)	$ 19,005,959	$ 29,091,054	$ 43,265,583
Investments (Note 4)	45,670,008	64,115,116	63,619,980
Investment Income Receivable	10,295,206	10,253,559	9,319,633
Assessments Receivable	277,838	244,694	518,163
Other Assets	26,470	29,487	27,796
Total Current Assets	75,275,481	103,733,910	116,751,155
Noncurrent Assets:			
Investments (Note 4)	1,109,437,616	1,037,562,443	923,188,573
Restricted Cash and Cash Equivalents (Note 4)	38,355,504	39,604,818	39,304,363
Capital Assets, Net of Accumulated Depreciation	872,084	671,568	561,313
Net Pension Asset	68,282	0	0
Total Noncurrent Assets	1,148,733,486	1,077,838,829	963,054,249
Total Assets	**1,224,008,967**	**1,181,572,739**	**1,079,805,404**
Deferred Outflows of Resources	**69,833**	**0**	**0**
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	**1,224,078,800**	**1,181,572,739**	**1,079,805,404**
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES			
Current Liabilities:			
Loss Liabilities—Current Portion (Note 5)	64,041,641	80,056,260	85,521,593
Assessments Received in Advance	2,116,322	2,637,951	5,442,261
Provider Refunds Payable	1,781,391	1,068,902	1,230,968
General and Administrative Expense Payable	195,254	194,361	53,413
Medical Mediation Panel Fees Payable (Note 6)	(1,535)	606	(4,139)
Total Current Liabilities	68,133,073	83,958,080	92,244,096
Noncurrent Liabilities:			
Loss Liabilities (Note 5):			
Loss Liability for Incurred but not Reported Losses	441,007,773	546,013,965	578,188,403
Loss Liability for Reported Losses	4,000,900	11,054,921	8,065,109
Loss Liability for Loss Adjustment Expense	80,414,776	99,288,363	107,428,738
Estimated Loss Liabilities	525,423,449	656,357,249	693,682,250
Amount Representing Interest	(79,739,980)	(99,505,978)	(105,012,754)
Discounted Loss Liabilities	445,683,469	556,851,271	588,669,496
Liabilities for Future Medical Expense	38,355,504	39,604,818	39,304,363
Contributions Being Held	2,000,000	0	0
Total Loss Liabilities	486,038,973	596,456,089	627,973,859
Less: Loss Liabilities—Current Portion	(64,041,641)	(80,056,260)	(85,521,593)
Noncurrent Loss Liabilities	421,997,332	516,399,829	542,452,266
Compensated Absences and OPEB Liabilities	94,985	106,950	98,371
Total Noncurrent Liabilities	422,092,317	516,506,779	542,550,637
Total Liabilities	**490,225,390**	**600,464,859**	**634,794,733**
Deferred Inflows of Resources	**1,062**	**0**	**0**
TOTAL LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	**490,226,452**	**600,464,859**	**634,794,733**
NET POSITION			
Net Position:			
Invested in Capital Assets	872,084	671,568	561,313
Restricted for Injured Patients and Families	732,980,264	580,436,312	444,449,358
TOTAL NET POSITION	**$ 733,852,348**	**$ 581,107,880**	**$ 445,010,671**

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Position for the Years Ended June 30, 2015, June 30, 2014, and June 30, 2013

	Year Ended June 30, 2015	Year Ended June 30, 2014	Year Ended June 30, 2013
OPERATING REVENUES			
Assessments	$ 33,735,169	$ 36,564,407	$ 38,585,018
Assessment Interest and Administrative Fee Income	38,081	43,831	35,973
Total Operating Revenues	**33,773,250**	**36,608,238**	**38,620,991**
OPERATING EXPENSES			
Underwriting Expenses:			
Net Losses Paid	16,817,086	10,982,444	16,377,289
Loss Adjustment Expenses Paid	4,384,870	4,382,016	4,373,419
Risk Management Expenses	107,443	70,360	52,824
Medical Expenses Paid	1,748,667	1,805,622	1,849,807
Change in Liability for Incurred but not Reported Losses	(105,006,192)	(32,174,437)	(41,022,790)
Change in Liability for Reported Losses	(7,054,021)	2,989,812	(12,081,565)
Change in Liability for Loss Adjustment Expense	(18,873,587)	(8,140,375)	(4,802,115)
Change in Amount Representing Interest	19,765,998	5,506,775	14,808,494
Change in Liability for Future Medical Expense	(1,249,314)	300,455	5,293,967
Total Underwriting Expenses	(89,359,050)	(14,277,328)	(15,150,670)
General and Administrative Expenses	607,387	945,978	738,693
Total Operating Expenses	**(88,751,663)**	**(13,331,350)**	**(14,411,977)**
OPERATING INCOME (LOSS)	**122,524,913**	**49,939,588**	**53,032,968**
NONOPERATING REVENUES (EXPENSES), AND TRANSFERS			
Investment Income	30,200,545	86,155,806	30,735,205
Miscellaneous Revenue (Expense)	34,219	18,646	(2,569)
Net Income Before Transfers	152,759,677	136,114,040	83,765,604
Transfers:			
Transfers to the General Fund	(15,209)	(16,831)	(16,547)
CHANGE IN NET POSITION	**152,744,468**	**136,097,209**	**83,749,057**
NET POSITION			
Net Position—Beginning of the Year	581,107,880	445,010,671	361,261,614
Net Position—End of the Year	$ 733,852,348	$ 581,107,880	$ 445,010,671

The accompanying notes are an integral part of this statement.

Statement of Cash Flows
for the Years Ended June 30, 2015, June 30, 2014, and June 30, 2013

	Year Ended June 30, 2015	Year Ended June 30, 2014	Year Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Received from Providers for Assessments	$ 34,174,418	$ 34,630,093	$ 44,336,557
Cash Received from Other Sources	192,068	73,110	338,156
Cash Paid for Losses	(14,817,086)	(10,982,443)	(16,377,289)
Cash Paid for Loss Adjustment Expenses	(4,384,870)	(4,382,016)	(4,373,419)
Cash Paid for Future Medical Expenses	(1,748,667)	(1,805,622)	(1,849,807)
Cash Paid for Other Expenses	(1,060,455)	(801,459)	(766,485)
Cash Paid to Providers for Refunds of Assessments	(303,091)	(763,840)	(612,852)
Cash Paid for Medical Mediation Panel Fees	(100,350)	(3,749)	(321,866)
Net Cash Provided by (Used for) Operating Activities	**11,951,967**	**15,964,074**	**20,372,995**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Transfers to the General Fund	(15,209)	(16,831)	(16,547)
Net Cash Provided by (Used for) Noncapital Financing Activities	**(15,209)**	**(16,831)**	**(16,547)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Cash Paid to Develop the Fund's Provider System	0	(170,076)	(136,872)
Net Cash Provided by (Used for) Capital and Related Financing Activities	**0**	**(170,076)**	**(136,872)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest Received	33,496,839	45,813,306	32,596,750
Cash Received as Proceeds from Sales of Investments	72,086,954	125,114,686	79,421,245
Cash Paid for Purchase of Investment Securities	(128,854,960)	(200,579,233)	(123,656,247)
Net Cash Provided by (Used for) Investment Activities	**(23,271,167)**	**(29,651,241)**	**(11,638,252)**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(11,334,409)**	**(13,874,074)**	**8,581,324**
Cash and Cash Equivalents—Beginning of the Year	68,695,872	82,569,946	73,988,622
Cash and Cash Equivalents—End of the Year	$ 57,361,463	$ 68,695,872	$ 82,569,946
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES			
Operating Income	$ 122,524,913	$ 49,939,588	$ 53,032,968
Adjustments to Reconcile Operating Income to			
Net Cash Provided by Operating Activities:			
Depreciation Expense	78,416	59,821	42,910
Miscellaneous Nonoperating Income (Expense)	34,220	18,646	(2,569)
Changes in Assets and Liabilities:			
Decrease (Increase) in Assessments Receivable	(33,144)	273,469	(273,022)
Decrease (Increase) in Other Assets	(275,915)	(1,692)	(351)
Increase (Decrease) in Loss Liabilities	(110,417,116)	(31,517,770)	(37,804,010)
Increase (Decrease) in Other Liabilities	40,593	(2,807,988)	5,377,069
Total Adjustments	(110,572,946)	(33,975,514)	(32,659,973)
Net Cash Provided by (Used for) Operating Activities	**$ 11,951,967**	**$ 15,964,074**	**$ 20,372,995**
Noncash Activities:			
Net Change in Unrealized Gains (Losses)	$ 4,290,645	$ 38,828,979	$ 249,246
Amortization of Bond Discounts	(7,294,215)	714,691	(697,150)

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ▪

1. Description of the Fund

The Injured Patients and Families Compensation Fund is part of the State of Wisconsin financial reporting entity and is reported as a major enterprise fund in the State's basic financial statements, which are included in the State's Comprehensive Annual Financial Report. The Fund, formerly known as the Patients Compensation Fund, was created in 1975 for the purpose of paying that portion of medical malpractice claims exceeding the legal primary insurance limits prescribed in s. 655.23 (4), Wis. Stats., or the maximum liability limit for which the health care provider is insured, whichever limit is greater. Most health care providers permanently practicing or operating in the State of Wisconsin are required to pay annual assessments.

Management of the Fund is vested with the 13-member Board of Governors, which is chaired by the Commissioner of Insurance. The Board has designated the Commissioner of Insurance as the administrator of the Fund. Similarly, under s. 655.27 (2), Wis. Stats., the Commissioner shall either provide staff services necessary for the operation of the Fund or, with the approval of the Board, contract for all or part of these services. During FY 2014-15, FY 2013-14, and FY 2012-13, the Board contracted for the Fund's actuarial, risk management, and claims administration services.

2. Summary of Significant Accounting Policies

A. Fund Accounting and Basis of Presentation

The financial statements of the Injured Patients and Families Compensation Fund have been prepared in conformance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). The accompanying financial statements were prepared based upon the flow of economic resources focus and full accrual basis of accounting, with revenues recognized when earned and expenses recognized when incurred.

The Statement of Revenues, Expenses, and Changes in Fund Net Position classifies the Fund's fiscal year activity as either operating or nonoperating. Because the Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions. Assessments, which are received from health care providers in exchange for coverage under the Fund, represent a significant component of operating revenues. Operating expenses include underwriting and administrative expenses.

Certain revenues and expenses that are not related to the Fund's primary purpose are reported as nonoperating revenues and expenses. The most significant source of the Fund's nonoperating income is investment income.

B. 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 could differ from those estimates. Estimates that are particularly susceptible to significant changes in future years are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 5 on ultimate and discounted loss liabilities.

C. Cash and Cash Equivalents

Cash and cash equivalents includes shares in the State Investment Fund, a short-term pool of state and local funds, and cash deposited in the State of Wisconsin's bank awaiting transfer to the State Investment Fund. The State Investment Fund shares are included in both the current portion of cash and cash equivalents and noncurrent portion restricted for future medical expenses.

D. Investment Valuation

Investments of the Fund consist of fixed income securities and shares in equity index funds. All investments are managed by the State of Wisconsin Investment Board and are reported at fair value. Fair value information is determined using quoted market prices.

E. Assessments

Assessments are billed and recognized as revenues on a fiscal year basis, which is also the policy year. Assessments received for the next fiscal year are treated as unearned revenue and reported as assessments received in advance. Accounts of providers are automatically credited and reported as provider refunds payable when primary insurance lapses.

F. Loss Liabilities

Loss liabilities are estimated based on recommendations of a consulting actuary and are discounted to the extent that they are matched by cash and invested assets. The uncertainties inherent in projecting the frequency and severity of claims, the Fund's unlimited liability coverage for economic damages, and extended reporting and settlement periods make it likely that the amounts ultimately paid will differ from the reported estimated liabilities.

G. Policy Acquisition Costs

Since the Fund has no marketing staff and incurs no sales commissions, acquisition costs are minimal and are charged to operations as incurred.

H. Capital Assets

The Fund capitalizes all assets, both tangible and intangible, which have a historic cost or estimated historic cost in excess of $5,000 and a useful life of two or more years. As of June 30, 2015, June 30, 2014, and June 30, 2013, the Fund's capital assets consisted of two assets: the internally developed provider system software, which is depreciated on a straight-line basis over fifteen years; and the microfiche reader, which is depreciated on a straight-line basis over five years.

I. Net Position

Section 655.27 (6), Wis. Stats., requires the Injured Patients and Families Compensation Fund to be held in an irrevocable trust and used for future claim payments for injured patients and families. Available net position is restricted for injured patients and families and totaled $732,980,264 as of June 30, 2015, $580,436,312 as of June 30, 2014, and $444,449,358 as of June 30, 2013.

3. NEW ACCOUNTING STANDARD

In June 2011, GASB issued Statement Number 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* The objective of this statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources in a statement of financial position and related disclosures. The adoption of this statement requires OCI to make changes and replace the Balance Sheet with the Statement of Net Position. In addition, the Statement of Revenues, Expenses and Changes in Fund Net Assets was replaced with the Statement of Revenues, Expenses and Changes in Fund Net Position. These changes were retroactively applied to the FY 2012-13 financial statements included in this report.

4. DEPOSITS AND INVESTMENTS

The Fund's deposits consist of cash in the State's bank, which totaled $295,463 as of June 30, 2015, $1,194,387 as of June 30, 2014, and $1,846,946 as of June 30, 2013.

The Fund's investments are managed by the State of Wisconsin Investment Board, whose objective is to maintain a portfolio of investments to provide a balance between capital appreciation, preservation of capital, and current income consistent with the needs of the Fund. Section 25.17 (3) (a), Wis. Stats., allows investments in loans, securities, and any other investments as authorized by s. 620.22, Wis. Stats. Classes of investments permitted by s. 620.22, Wis. Stats., include bonds of governmental units or private corporations, loans secured by mortgages, preferred or common stock, real property, and other investments not specifically prohibited by statute. In addition, the Board of Governors established a more specific investment policy that limits equity investments to 20.0 percent of the Fund's total portfolio.

Although classified as cash and cash equivalents on the Statement of Net Position and the Statement of Cash Flows, shares in the State Investment Fund are subject to investment risk disclosures. The State Investment Fund is a short-term investment pool of state and local funds managed by the State of Wisconsin Investment Board, with oversight by its Board of Trustees and in accordance with Wisconsin Statutes. It is not registered with the U.S. Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported at fair value as of June 30. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17 (3) (b), (ba), (bd), and (dg), Wis. Stats., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States including solvent financial institutions in Wisconsin, and banker acceptances. The Board of Trustees may specifically approve other prudent legal investments. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The fair values of the Fund's investments at fiscal year-end are as follows:

	June 30, 2015	June 30, 2014	June 30, 2013
Short-term Investment Pool:			
State Investment Fund[1]	$ 57,066,000	$ 67,501,000	$ 80,723,000
Fixed Income:			
U.S. Government and Agency	394,325,230	347,176,767	316,424,993
Industrial	239,464,385	238,835,133	202,378,336
Transportation	37,982,924	39,180,152	35,742,395
Finance	130,220,688	131,017,628	113,628,669
Utilities	130,854,133	134,772,148	118,936,966
Subtotal	932,847,360	890,981,828	787,111,359
Equities:			
Russell 2000 Index Fund	17,976,570	16,820,901	16,821,548
S & P 500 Index Fund	159,480,071	148,392,163	143,929,034
S & P 400 Index Fund	15,222,483	14,291,052	14,139,172
MSCI World Ex-US Index Fund	29,581,140	31,191,615	24,807,440
Subtotal	222,260,264	210,695,731	199,697,194
Total	$1,212,173,624	$1,169,178,559	$1,067,531,553

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

Custodial Credit Risk for Deposits—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Fund will not be able to recover deposits that are in possession of an outside party. The Fund does not have a deposit policy specifically for custodial credit risk. The Fund's bank balances were not fully covered by the Federal Deposit Insurance Corporation's (FDIC's) insurance policy of up to $250,000. The Fund was exposed to custodial credit risk of $45,463 as of June 30, 2015, $944,387 as of June 30, 2014, and $1,596,946 as of June 30, 2013.

Custodial Credit Risk for Investments—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investments that are in possession of an outside party. The Fund does not have an investment policy specifically for custodial credit risk. As of June 30, 2015, June 30, 2014, and June 30, 2013, the Fund did not have any investments exposed to custodial credit risk.

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Fund. As of June 30, 2015, the Fund's investment guidelines provide that, at the time of purchase, at least 80.0 percent of the bond portfolio must be rated A3/A- or better by nationally recognized statistical rating organizations, using the lower of split ratings. In addition, the Fund's investment guidelines require that a minimum of 30.0 percent of the Fund's investable assets (excluding the cash restricted for payment of future medical expenses) must be invested in U.S. Treasury or agency securities. The State Investment Fund is unrated; however, its guidelines establish specific maximum exposure limits by security type based on the minimum credit ratings as issued by nationally recognized statistical rating organizations.

The credit exposures aggregated by credit rating as of June 30, were as follows:

	June 30, 2015		June 30, 2014		June 30, 2013	
	Fair Value	Percentage	Fair Value	Percentage	Fair Value	Percentage
Credit Rating:						
AAA	$ 15,937,995	1.6%	$ 16,006,686	1.7%	$ 15,999,648	1.8%
AA	425,630,118	43.0	378,516,407	39.5	345,272,276	39.8
A	336,069,566	34.0	324,842,305	33.9	277,858,137	32.0
BBB	149,847,635	15.1	160,898,421	16.8	132,446,114	15.3
BB	5,348,446	0.5	10,711,759	1.1	15,535,134	1.8
B	0	0.0	0	0.0	0	0.0
C or Lower	0	0.0	0	0.0	0	0.0
Not Rated	13,600	0.0	6,250	0.0	50	0.0
Subtotal	932,847,360	94.2	890,981,828	93.0	787,111,359	90.7
State Investment Fund (unrated)[1]	57,066,000	5.8	67,501,000	7.0	80,723,000	9.3
Total	$989,913,360	100.0%	$958,482,828	100.0%	$867,834,359	100.0%

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

Concentration of Credit Risk—Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. As of June 30, 2015, the Fund's investment guidelines do not allow for investments in any one single issuer that are in excess of 5.0 percent of the Fund's bond portfolio based on fair value at the time of purchase. Securities of the United States government and its agencies are excluded from that limitation. As of June 30, 2015, June 30, 2014, and June 30, 2013, the Fund did not have more than 5.0 percent of its total investments in a single issuer, excluding the United States government and its agencies. Concentration of credit risk requirements are also not applicable to pooled investments, such as the State Investment Fund.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund uses the duration method to identify and manage its interest rate risk. As of June 30, 2015, the Fund's investment guidelines related to interest rate risk provide that the average duration of the aggregate bond portfolio should be less than ten years. The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year.

The following were the durations for each type of fixed income security held, as well as for the State Investment Fund:

	June 30, 2015		June 30, 2014		June 30, 2013	
	Fair Value	Duration (in years)	Fair Value	Duration (in years)	Fair Value	Duration (in years)
Type of Security:						
Government/Agency	$394,325,230	6.26	$347,176,767	5.77	$316,424,993	5.35
Corporate	538,522,130	5.64	543,805,061	6.06	470,686,366	6.21
Subtotal	932,847,360	5.90	890,981,828	5.95	787,111,359	5.86
State Investment Fund[1]	57,066,000	0.22	67,501,000	0.24	80,723,000	0.09
Total	$989,913,360	5.57	$958,482,828	5.55	$867,834,359	5.33

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2015, June 30, 2014, and June 30, 2013, the Fund did not directly own any issues denominated in a foreign currency.

5. TOTAL LOSS LIABILITIES

A. Estimated Loss Liabilities

Loss liabilities include individual case estimates for reported losses and estimates for losses that have been incurred but not reported (IBNR), based upon the projected ultimate losses recommended by a consulting actuary. Individual case estimates of the liability for reported losses and net losses paid from inception of the Fund are deducted from the projected ultimate loss liabilities to determine the liability for IBNR losses as follows:

	June 30, 2015	June 30, 2014	June 30, 2013
Projected Ultimate Loss Liability	$1,217,602,779	$1,291,897,367	$1,302,146,134
Less:			
Net Losses Paid from Inception	(861,595,840)	(846,242,258)	(833,143,325)
Liability for Reported Losses	(4,000,900)	(11,054,921)	(8,065,109)
Risk Margin	89,001,734	111,413,777	117,250,703
Liability for IBNR Losses	$ 441,007,773	$ 546,013,965	$ 578,188,403

The Fund's consulting actuary developed a best estimate of the loss liabilities, and the Board of Governors approved the addition of an explicit 25.0 percent risk margin to the best estimate for June 30, 2015, June 30, 2014, and June 30, 2013. The explicit risk margin is applied to ensure that the loss liability estimates remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments.

Loss liabilities also include a provision for the estimated future payment of costs to settle claims. The actuary estimates the ultimate loss adjustment expense (LAE) using data available through September 30 of the fiscal year. The actuary estimates the LAE at 18.0 percent of the estimated unpaid loss liabilities as of June 30, 2015, June 30, 2014, and June 30, 2013. Because the actuary's estimate occurs before the end of the fiscal year and is based on an estimate of the cumulative payments, the percentage used by the actuary in determining the LAE will differ slightly from the percentages calculated using actual LAE payments in the financial statements. The LAE paid from inception of the Fund are deducted from the projected ultimate LAE provision to arrive at the liability for the LAE as follows:

	June 30, 2015	June 30, 2014	June 30, 2013
Projected Ultimate LAE Liability	$156,060,418	$166,773,646	$168,903,576
Less:			
Net LAE Paid from Inception	(91,728,597)	(87,342,955)	(82,960,586)
Risk Margin	16,082,955	19,857,672	21,485,748
Liability for LAE	$ 80,414,776	$ 99,288,363	$107,428,738

B. Re-estimated Loss Liabilities

Because of the uncertainties inherent in projecting medical malpractice claims with unlimited liability coverage, estimates of the Fund's loss liability and liability for the LAE are continually reviewed and adjusted as the Fund gains additional experience. Such adjustments are reflected in current operations. Because of the changes in these estimates for prior years, the total underwriting expenses reported for the year are not necessarily indicative of the loss experience for that year.

C. Discounted Loss Liabilities

Section Ins 17.27 (3), Wis. Adm. Code, requires the liability for reported losses, liability for IBNR losses, and liability for the LAE to be maintained on a present-value basis, with the difference from full value being reported as a contra account to the loss liabilities. The loss liabilities are discounted only to the extent that they are matched by cash and invested assets. The actuarially determined discount factors, which are based on the investment rate assumption of 4.5 percent for

FY 2014-15, FY 2013-14, and FY 2012-13 that are approved by the Board of Governors, were 0.848 for FY 2014-15, 0.848 for FY 2013-14, and 0.849 for FY 2012-13.

D. Future Medical Expense Liability

Section 655.015, Wis. Stats., requires accounts to be established if a settlement or judgment provides for future medical expense (FME) payments in excess of $100,000. In addition to amounts provided by the Fund, this account may also include deposits provided by the primary insurer for any portion of future medical expenses for which they are liable. The accounts are managed by the Fund and earn a proportionate share of the Fund's interest. Any account balance remaining when a claimant dies reverts back to the Fund.

E. Contributions Being Held Liability

A primary insurer may voluntarily present a nonrefundable payment to the Fund generally equal to the amount of primary coverage in effect for the related claim. This payment from the primary insurer is negotiable with the Fund in exchange for a release of payment for any future defense costs that may be incurred on the claim. This amount is held as a liability on the Fund's financial statements until the time a payment is made on the claim. Contributions of $2.0 million were being held as of June 30, 2015. No contributions were being held as of June 30, 2014, and June 30, 2013.

F. Loss Liabilities Balances and Activities (in thousands)

	FY 2014-15	FY 2013-14	FY 2012-13
Total Loss Liabilities, Beginning of the Year	$596,456	$627,974	$665,778
Incurred Losses and Related Expenses for the Current Year and Changes in the Estimated Liabilities for Prior Year Losses and Related Expenses	(89,359)	(14,277)	(15,151)
Less: Current Year Payments for Losses, LAE, and FME Incurred in the Current and Prior Years	(21,058)	(17,241)	(22,653)
Total Loss Liabilities, End of the Year	486,039	596,456	627,974
Less: Current Portion	(64,042)	(80,056)	(85,522)
Noncurrent Portion	$421,997	$516,400	$542,452

6. MEDICAL MEDIATION PANEL FEES

Section Ins 17.27 (3), Wis. Adm. Code, requires the fees collected for administration of the Medical Mediation Panel to be included in the Fund's financial reports, but that the fees should not be regarded as assets or liabilities of the Fund or otherwise taken into consideration in determining assessment levels to pay claims. The Fund remitted panel fees to the Wisconsin Supreme Court of $100,350 in FY 2014-15, $3,749 in FY 2013-14, and $321,866 in FY 2012-13.

7. Claim Annuities

The settlement of a claim may result in the purchase of an annuity. Under specific annuity arrangements, the Fund may have ultimate responsibility for annuity payments if the annuity company and the reassignment company default on annuity payments.

One of the Fund's annuity providers defaulted on $110,733 in annuity payments through June 30, 2015, which the Fund subsequently paid. The annuity provider is currently making the majority of these annuity payments, but the Fund continues to make monthly annuity payments of $130, and additional lump-sum payments due every five years through 2025, to cover defaulted payments. Through June 30, 2015, the Fund has received a total reimbursement of $92,797, which includes interest. It is unclear when the annuity provider will be able to make the remaining annuity payments and whether the Fund will be able to recover the remaining annuity payments made on the behalf of the annuity provider.

The total estimated replacement value of the Fund's annuities of which the Fund remains the owner was $32.8 million as of June 30, 2015, June 30, 2014, and June 30, 2013. Of this amount, $651,753 represents the replacement value of the annuity in default as of June 30, 2015.

8. Audit Adjustments

The unaudited financial statements presented in the Commissioner of Insurance's annual reports to the Governor and the Legislature have been adjusted to reflect recommended audit adjustments.

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Auditor's Report ■

STATE OF WISCONSIN
Legislative Audit Bureau
22 East Mifflin Street, Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab
Joe Chrisman
State Auditor

Celebrating 50 Years of Service 1966-2016

Report 16-4

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Theodore K. Nickel, Commissioner
Office of the Commissioner of Insurance

We have audited the financial statements and the related notes of the Injured Patients and Families Compensation Fund as of and for the years ended June 30, 2015, June 30, 2014, and June 30, 2013, and have issued our report thereon dated March 3, 2016. 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,* which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Injured Patients and Families Compensation Fund is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits of the financial statements, we considered the Injured Patients and Families Compensation Fund's internal control to determine the audit procedures that are appropriate in the circumstances 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 Injured Patients and Families Compensation Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Injured Patients and Families Compensation Fund's financial statements are free from material misstatement, we performed tests of 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the Injured Patients and Families Compensation Fund's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

March 3, 2016

Response ■

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Injured Patients and Families Compensation Fund

Scott Walker, *Governor*
Theodore K. Nickel, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-6830 • Fax: (608) 266-8064
E-Mail: ociipfcf@wisconsin.gov
Web Address: oci.wi.gov/pcf.htm

March 3, 2016

Mr. Joe Chrisman, State Auditor
Legislative Audit Bureau
22 East Mifflin Street, Suite 500
Madison, WI 53703

Dear Mr. Chrisman:

Thank you for providing a copy of the audit report for the Injured Patients and Families Compensation Fund. We appreciate the opportunity to respond to the following recommendations:

We recommend the Office of the Commissioner of Insurance continue to work with the Board of Governors to monitor the Fund's net position; and develop a plan to bring the net position within the target range established by the Board of Governors.

The Board of Governors (Board) of the Injured Patients and Families Compensation Fund (Fund) recognizes that the Fund continues to be in a financial position in which there is a healthy balance. Following report 13-4 dated March, 2013, the Board had already shifted its focus to the management of this balance. As a result of report 13-4, the Office of the Commissioner of Insurance (OCI) annually receives an analysis from its contracted actuary who has determined a reasonable range to target minimum and maximum net position balances for the Fund.

The Board of Governors' (Board) actions of this annual analysis has been the yearly decreases in the annual assessment rates. For fiscal year 2013-2014 the Board approved a 5.0 percent decrease in assessment rates followed by a decrease of 10 percent for fiscal year 2015, a decrease of 34 percent for fiscal year 2016 and has approved an additional 30 percent decrease in the assessment rates for fiscal year 2017. These decreases establish lower than actuarially indicated assessment rates, however, the investment income of the Fund have continued to increase the net position of the fund during the past four years.

We recommend that the Office of the Commissioner of Insurance comply with the policy of the Board of Governors to have an actuarial audit completed every three years; ensure that the actuarial audit include a review of the recommended target range for the Fund's net position; and report to the Joint Legislative Audit Committee by September 30, 2016, on the status of the actuarial audit.

The OCI fully supports this recommendation and will work diligently with staff to continue to comply with the policy of having an actuarial audit completed every three years. The additional recommendation to incorporate a review of the target range for the Fund's net position is welcome and we support this request.

In closing, the Office of the Commissioner of Insurance appreciates the courtesy and assistance Legislative Audit Bureau staff extended during the audit. OCI also appreciates and recognizes the substantial time and effort provided by the audit team.

Thank you for the opportunity to respond to the audit. Please contact me if you have any questions.

Sincerely,

Theodore K. Nickel
Commissioner of Insurance

TKN:tlc

cc: Kate Ludlum, Insurance Administrator
Terri Carlson, Insurance Program Manager