Report 05-15
October 2005

An Audit

Local Government Property Insurance Fund

Office of the Commissioner of Insurance

LEGISLATIVE AUDIT BUREAU

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Janice Mueller
State Auditor

October 27, 2005

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

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. The Property Fund is administered by the Office of the Commissioner of Insurance (OCI). As of June 30, 2004, it insured $35.9 billion in property owned by 1,203 local units of government. We have provided an unqualified auditor's report on the Property Fund's financial statements for the fiscal years (FYs) ending June 30, 2004, 2003, 2002, and 2001.

Because of changes in reinsurance coverage and increases in claims, the Property Fund experienced net losses of $8.1 million for the three-year period ending June 30, 2003. In response, OCI increased policyholder premiums. Following this increase, the Property Fund ended FY 2003-04 with net income of $9.2 million and a surplus of $24.5 million. OCI monitors the surplus level and believes it is currently appropriate in light of recent loss experience and recent changes in reinsurance.

In completing our audit, we encountered a serious documentation problem: a subcontractor for the previous fund administrator destroyed nearly all claim files for FYs 2000-01 and 2001-02. In order to provide the necessary documentation and assurances that claim payments were properly made, OCI had the destroyed claim files re-created with the assistance of the current fund administrator and local governments. OCI was able to provide an adequate level of documentation to allow us to provide an unqualified opinion on the financial statements.

We appreciate the courtesy and cooperation extended to us by OCI staff and the private firms responsible for administration of the Property Fund. OCI's response follows our report.

Respectfully submitted,

Janice Mueller

Janice Mueller
State Auditor

JM/CS/ss

Report Highlights ▪

Our auditor's report is unqualified.

The Property Fund's surplus declined to $15.3 million at the end of FY 2002-03, but it has since rebounded.

Since the end of FY 2003-04, participation in the Property Fund has declined from 1,203 to 1,160 local units of government.

Most claim files for FYs 2000-01 and 2001-02 were destroyed by a subcontractor.

The Local Government Property Insurance Fund was created by the State to make reasonably priced property insurance available to counties, cities, towns, villages, school districts, and other local units of government. It insures buildings, motor vehicles, libraries, and other property. The Property Fund must accept any local government that wishes to participate, and it cannot place restrictions on the type of property covered. As of June 30, 2004, it insured approximately $35.9 billion in property owned by 1,203 policyholders.

The Office of the Commissioner of Insurance (OCI) has statutory responsibility for administering the Property Fund. However, policies are issued, premiums are collected, and claims are paid primarily through private contractors. Both claims and administrative expenses are financed through policyholder premiums and investment earnings.

Section 13.94(1)(de), Wis. Stats., requires the Legislative Audit Bureau to audit the Property Fund. As part of this financial audit, we:

- reviewed financial records, supporting documentation, and control procedures;
- assessed the fair presentation of financial statements for fiscal years (FYs) 2003-04, 2002-03, 2001-02, and 2000-01;

- reviewed compliance with statutory provisions; and

- discussed various issues with OCI staff and the fund administrator.

We have provided an unqualified auditor's report on the Property Fund's financial statements but reported a material weakness in internal controls related to the premature destruction of claim files.

Financial Status

Increases in claims and changes in reinsurance terms and costs caused the Property Fund to incur net losses in three of the four years we audited. As shown in Table 1, these losses totaled $8.1 million. However, increases in policyholder premium rates allowed the Property Fund to earn net income of $9.2 million for FY 2003-04. Premium rates have been reduced since our audit period ended.

Table 1

Net Income (Loss)

Fiscal Year	Net Income (Loss)
2000-01	$(2,078,946)
2001-02	(3,553,756)
2002-03	(2,483,591)
2003-04	9,236,418

The Property Fund experienced a significant increase in policyholder claims. Total claims averaged $14.4 million per year from FY 1997-98 through FY 2003-04, compared to $6.5 million per year from FY 1989-90 through FY 1996-97. Increases in both the number of policyholders and the value of property insured have contributed to the increase in claims.

To mitigate the risk of large claims, the Property Fund purchases reinsurance. From FY 1997-98 through FY 1999-2000, reinsurance significantly limited the effects of large losses by paying $19.2 million in claims. During that same three-year period, the Property Fund paid $4.0 million in premiums to reinsurers.

However, the lead reinsurer cancelled its contract with the Property Fund effective January 5, 2001. A new reinsurer was selected, but reinsurance terms were less favorable. The terrorist attacks of September 11, 2001, caused additional changes in the reinsurance market, and the terms of the Property Fund's contract were again changed. Premiums paid to reinsurers increased from $1.1 million in FY 1999-2000 to $5.7 million in FY 2003-04. In addition, reinsurance did not begin to cover claims until the Property Fund had incurred significantly higher claims. For example, between 2001 and 2003, the aggregate annual threshold after which reinsurance would pay claims rose from $6.0 million to $18.0 million annually.

Because of the changes in reinsurance contract terms, the Property Fund began to pay a larger percentage of claims directly. From FY 1997-98 through FY 1999-2000, reinsurers paid 45.1 percent of total claims. From FY 2000-01 through FY 2003-04, they paid only 11.0 percent of total claims.

Although the Property Fund now pays a larger portion of claims, reinsurance continues to serve the same purpose it had in the past: providing coverage when unusually high or unexpected losses occur. OCI continues to monitor reinsurance use and the terms of its reinsurance contracts.

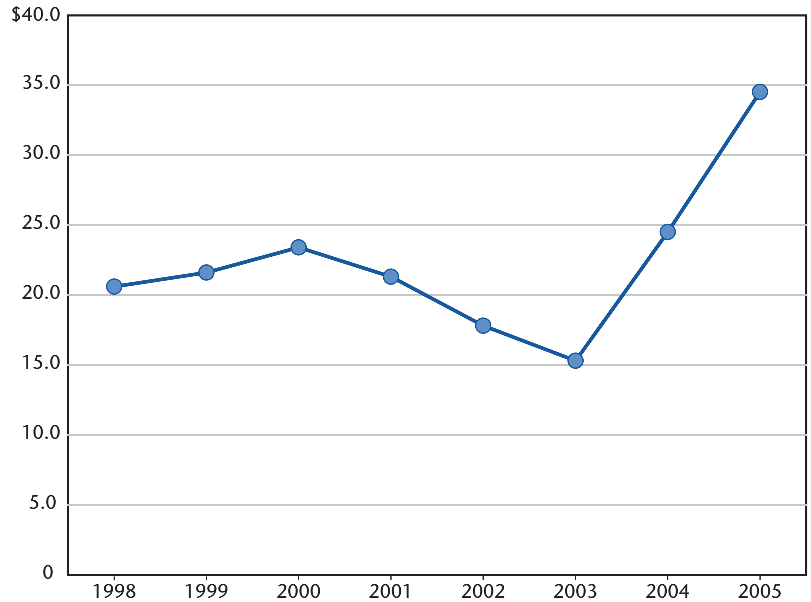
To ensure that policyholder premiums were adequate to cover the Property Fund's increased reinsurance costs and loss exposure, OCI increased them three times between July 1, 2001 and July 1, 2003. As a result, revenues from premiums paid by policyholders increased from $11.4 million in FY 2000-01 to $26.7 million in FY 2003-04.

Surplus Balance

The premium rate increases implemented by OCI allowed the Property Fund to improve its financial position in FY 2003-04. Net income was $9.2 million, and the year ended with a surplus balance of $24.5 million, as shown in Figure 1. Unaudited financial statements for FY 2004-05 show a surplus balance of $34.5 million.

Figure 1

Surplus Balance
For the Fiscal Year Ended June 30[1]
(In Millions)



[1] For 2005, the balance reported is based on unaudited financial statements.

An adequate surplus balance is important for the Property Fund's financial stability. OCI has established a target surplus of at least $20 million, with a premium-to-surplus ratio of 1 to 1. That is, for every $1 of premiums written, the Property Fund should have $1 of surplus. As of June 30, 2005, the Property Fund's premium-to-surplus ratio was 1 to 1.37.

The Property Fund is different than private insurance companies in that it cannot diversify its insurance program across different types of insurance or outside of Wisconsin. This creates different risks, which may justify maintaining the surplus at a higher level. OCI believes the surplus balance is appropriate given the recent changes in premium rates and reinsurance, and the unique characteristics of the Property Fund. However, it should continue to monitor the surplus balance to ensure it is not too large, especially given the fiscal constraints currently faced by participating local governments.

Property Fund Participation

Participation in the Property Fund increased over the four-year period of our audit, from 1,113 policyholders at the beginning of FY 2000-01 to 1,203 at the end of FY 2003-04. However, participation has since declined. As of June 30, 2005, 1,160 local governments purchased insurance through the Property Fund.

Some of the decline in participation may be attributable to increases in policyholder premium rates. However, increased competition in the insurance market could also be affecting the Property Fund. Under 2003 Wisconsin Act 78, which took effect in December 2003, municipal mutual insurance carriers may sell property insurance. Previously, they could sell only worker's compensation insurance, liability insurance, and risk management services. OCI should continue to monitor trends in Property Fund participation.

Destruction of Claim Files

During the course of our fieldwork, we found that a subcontractor hired by the Property Fund's previous administrator had destroyed nearly all documentation to support claims paid in FYs 2000-01 and 2001-02. Claim files are important because they provide the documentation necessary to support paid claims. Without this information, the Audit Bureau could not provide an opinion on the Property Fund's financial statements.

Working with the current fund administrator and local governments, OCI re-created the missing claim files. However, the process delayed our audit significantly, and extra costs were incurred by both OCI and this office. According to OCI, these extra costs will be paid by the previous fund administrator.

We note that the claim files were destroyed in violation of the State's record-retention rules. The destruction of the files occurred two years after the transition to the new fund administrator. OCI could have been expected to take additional steps to ensure that claim files were properly safeguarded.

In a separate management letter, we make recommendations for OCI to include specific language in its contract with the current fund administrator to define the State's requirements for retaining Property Fund documents. We also recommend that steps be taken to ensure any additional claim files held by the previous fund administrator or its subcontractor be properly maintained.

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Introduction ■

The Local Government Property Insurance Fund was created from the State Property Insurance Fund in 1979.

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 Local Government Property Insurance Fund was created from the State Property Insurance Fund to insure government properties that are not owned by the State. Coverage of state-owned property was transferred to a self-funded program administered by the Wisconsin Department of Administration.

OCI assigns one full-time employee to serve as its liaison with the contractors that provide most Property Fund services, and to answer technical questions raised by the contractors and policyholders. In addition, two OCI committees provide guidance in managing the Property Fund: the Advisory Committee, which consists of representatives of local governments participating in the Property Fund, and the Oversight Committee, which consists of OCI staff and representatives of the Advisory Committee.

In June 2004, the Property Fund insured $35.9 billion in property owned by 1,203 local units of government.

The Property Fund covers all property losses except those resulting from flood, earthquake, wear and tear, extremes in temperature, mold, war, nuclear reactions, and embezzlement or theft by an employee. It 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 or from information available on OCI's Web site. As shown in Table 2, the Property Fund insured 1,203 local units of government in June 2004. At that time, the property it insured was valued at $35.9 billion.

Table 2

Number and Type of Policyholders
(As of June 30)

Governmental Unit	2000	2001	2002	2003	2004
Counties	71	71	72	72	65
Cities	137	151	161	165	170
Towns	308	282	270	257	224
Villages	203	220	246	260	283
School Districts	282	296	323	334	333
Other	112	113	111	118	128
Total	**1,113**	**1,133**	**1,183**	**1,206**	**1,203**
Insurance in Force (In Billions)	$25.1	$27.6	$29.7	$32.7	$35.9

Financial Status

The Property Fund experienced net losses each year from FY 2000-01 through FY 2002-03.

Local governments that participate in the Property Fund pay annual premiums based on the value of their insured property. Over the years, the Property Fund has generally earned more in premiums than it has paid policyholders in claims. This net income had allowed it to maintain relatively steady premiums and an adequate cumulative surplus balance, which is the net assets available to cover claims. However, as shown in Table 3, the Property Fund experienced three years of net losses beginning in FY 2000-01.

Table 3

Net Income (Loss)

Fiscal Year	Net Income (Loss)
1997-98	$ 1,543,842
1998-99	963,604
1999-2000	1,830,529
2000-01	(2,078,946)
2001-02	(3,553,756)
2002-03	(2,483,591)
2003-04	9,236,418

Changes in reinsurance contributed to the Property Fund's net losses.

The net losses over this three-year period resulted primarily from an increase in claims and from changes in reinsurance coverage. In response to these changes, OCI increased its premiums charged to policyholders. It returned to profitability in FY 2003-04.

To reduce its exposure to large or excess claim losses, the Property Fund purchases reinsurance. The three-year reinsurance contract covering FYs 1997-98, 1998-99, and 1999-2000 paid individual claims that exceeded $500,000. In addition, once the Property Fund incurred a total of $6.0 million in claims each year, reinsurance covered all claims, less a $10,000 deductible per claim.

The Property Fund's total claims increased beginning in FY 1997-98. Total claims, including those paid by reinsurance, averaged $14.4 million per year from FY 1997-98 through FY 2003-04, compared to $6.5 million per year from FY 1989-90 through FY 1996-97. Increases in both the number of policyholders and the value of property insured contributed to the increase in claims. From FY 1989-90 through FY 2003-04, the value of insured property increased $21.8 billion, from $14.1 billion to $35.9 billion.

The Property Fund benefited from favorable reinsurance terms for the three-year period that ended June 30, 2000.

Because of the favorable reinsurance terms, reinsurers covered a larger percentage of total claims as they increased, which benefited the Fund. As shown in Table 4, from FY 1997-98 through FY 1999-2000, reinsurance paid claims of $19.2 million, but the Property Fund paid only $4.0 million in reinsurance premiums.

Table 4

Reinsurance Premiums and Claims Paid by Reinsurance

Fiscal Year	Reinsurance Premiums	Claims Paid by Reinsurance
1997-98	$1,875,304	$ 7,957,396
1998-99	1,023,219	5,423,057
1999-2000	1,055,074	5,856,128
Total	**$3,953,597**	**$19,236,581**

However, after several years of favorable reinsurance terms, the cost and terms for the Property Fund's reinsurance have become significantly less favorable. First, the lead reinsurer invoked a cancellation clause in the middle of the FY 2000-01 reinsurance contract period and ended its coverage for the Property Fund effective January 5, 2001. Although the Property Fund signed a new reinsurance contract effective from January 1 through November 30, 2001, its terms were less favorable. Because of the Property Fund's loss experience, the new threshold at which reinsurance began paying claim amounts increased from $500,000 to $2 million. In addition, the aggregate threshold after which reinsurance paid all claims increased from $6.0 million to $11.0 million.

Payments for reinsurance have tripled, and the Property Fund pays a significantly larger percentage of policyholder claims.

The terrorist attacks of September 11, 2001, further affected the reinsurance market, and reinsurance terms were again revised. While the per claim threshold remained $2.0 million, the annual aggregate threshold increased to $13 million from December 1, 2001, through December 31, 2002, and to $18 million for calendar year 2003. Reinsurance thresholds have not changed significantly since the calendar year 2003 contract. However, as shown in Table 5, the Property Fund has begun to pay a significantly larger percentage of policyholder claims because of changes in reinsurance terms. Furthermore, from FY 1997-98 through FY 2003-04, payments made for reinsurance premiums tripled, increasing from $1.9 million to $5.7 million.

Table 5

Claims Summary

Fiscal Year	Claims Paid by Reinsurance	Claims Paid by the Fund	Total Claims	Percentage of Claims Paid by the Fund
1997-98	$7,957,396	$ 7,105,526	$15,062,922	47.2%
1998-99	5,423,057	8,392,766	13,815,823	60.7
1999-2000	5,856,128	7,872,577	13,728,705	57.3
2000-01	2,405,279	12,375,801	14,781,080	83.7
2001-02	221,222	14,159,149	14,380,371	98.5
2002-03	3,723,913	14,852,240	18,576,153	80.0
2003-04	86,557	10,523,346	10,609,903	99.2

Although the Property Fund now pays a larger portion of claims, reinsurance continues to serve the same purpose it had in the past: providing coverage when unusually high or unexpected losses occur. OCI continues to monitor reinsurance use and the terms of its reinsurance contracts.

Beginning in FY 2000-01, policyholder premiums were not adequate to cover losses, and the Property Fund's surplus balance declined. As a result, OCI sought increases in the policyholder premiums. Over the four-year period of our audit, OCI increased premium rates on three occasions.

OCI increased Property Fund premium rates three times during our four-year audit period.

The first premium rate increase took effect on July 1, 2001. It was determined internally by OCI. Two later premium rate increases were based on studies by an actuarial firm hired by OCI. As a result of these changes, policyholder premiums increased 134.7 percent, from $11.4 million in FY 2000-01 to $26.7 million in FY 2003-04.

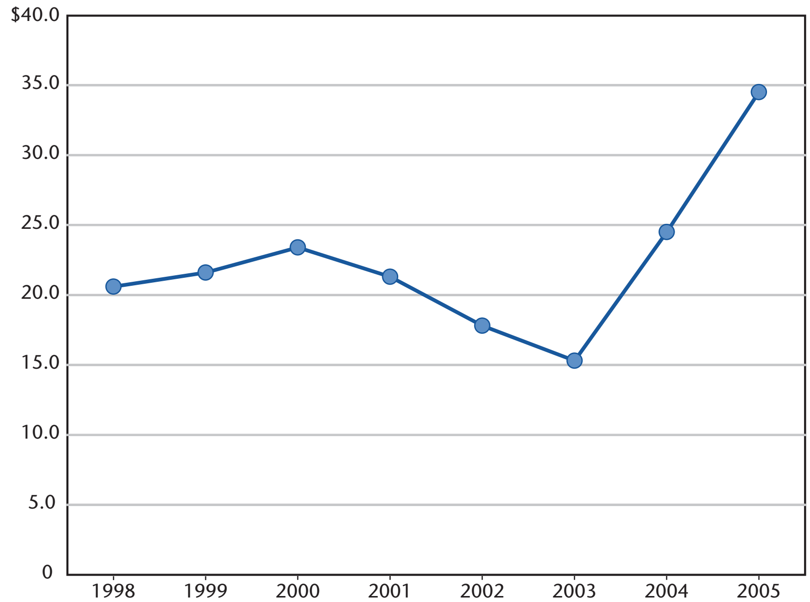
Surplus Balance

The Property Fund ended FY 2003-04 with a surplus balance of $24.5 million.

The premium rate increases implemented by OCI and a decline in claims in FY 2003-04 have increased the Property Fund's surplus balance. The surplus had declined to a low of $15.3 million at the end of FY 2002-03, but net income of $9.2 million allowed it to improve to $24.5 million by the end of FY 2003-04, as shown in Figure 2. OCI is reporting a surplus balance of $34.5 million on its unaudited statutory-basis financial statements for the period ending June 30, 2005.

Figure 2

Surplus Balance
For the Fiscal Year Ended June 30[1]
(In Millions)



[1] For 2005, the balance reported is based on unaudited financial statements.

An adequate surplus balance is important to ensure the financial stability of the Property Fund.

An adequate surplus balance is necessary to ensure the Property Fund's financial stability. The larger the surplus, the greater the assurance that sufficient funds will be available to pay claims. In addition, an adequate surplus level helps to ensure the stability of premium rates and the availability and affordability of reinsurance coverage. However, defining what constitutes an adequate surplus balance can be difficult and varies from entity to entity.

In the mid-1990s, we raised concerns that OCI was maintaining its surplus balance above the industry standard and recommended that it develop guidelines for setting an adequate surplus. OCI subsequently implemented procedures to monitor the surplus balance, took steps to reduce the balance, and established a target premium-to-surplus ratio of 1 to 2, which indicates that for every $1 of premiums written, the Property Fund should have $2 in surplus. Recently, with the changes in the premium structure and reinsurance, OCI has reevaluated the established surplus guidelines.

OCI has established a target minimum surplus balance of at least $20 million.

In its April 14, 2004 meeting, the Advisory Committee recommended a target minimum surplus of $20 million with an overall goal of a premium-to-surplus ratio of 1 to 1, which indicates that for every $1 of premiums written, the Property Fund should have $1 in surplus. The minimum target of $20 million is based on Wisconsin Administrative Code, which requires that no single risk assumed by an insurance company exceed 10 percent of surplus. Since reinsurance covers individual claims exceeding $2 million, the Advisory Committee set the minimum surplus target at $20 million. This amount was approved by the Oversight Committee at its April 19, 2004 meeting.

The surplus balance has increased to $34.5 million as of June 30, 2005.

As of June 30, 2004, the Property Fund was at a premium-to-surplus ratio of 1.1 to 1. However, since that time, the surplus balance has continued to increase. It is reported at $34.5 million as of June 30, 2005, with a premium-to-surplus ratio of 1 to 1.37. OCI continues to maintain a surplus balance that is more conservative than the industry average, which is currently a ratio of approximately $2 of premiums for every $1 of surplus.

It is important that OCI continue to monitor the appropriateness of the surplus balance.

It may be appropriate for the Property Fund to maintain a higher surplus than the industry average given its unique characteristics: because the Property Fund cannot diversify across different types of insurance or outside of Wisconsin, it is susceptible to different types of risk. Nevertheless, it is important that OCI continue to monitor the surplus balance to ensure it is appropriate, especially given the fiscal constraints facing participating local governments.

Subsequent to the end of our audit period, two significant changes occurred. First, after several years of rate increases, OCI informed local governments in May 2005 that premiums would be reduced. The decision to reduce premiums was supported by an actuarial study completed by a private contractor, which concluded the Property Fund's current rates were adequate to cover anticipated losses and expenses and that rates could be decreased or left at the current level to allow further build-up of the surplus balance. OCI believes the surplus balance has reached an adequate level, and thus chose to reduce rates. Premium rates were reduced by approximately 16.0 percent for renewing policyholders, and by an even larger percentage for some categories of new policyholders. The rate reductions took effect in June and December 2005.

Since June 30, 2004, participation in the Property Fund has declined from 1,203 to 1,160 local governments.

Second, through June 30, 2005, participation in the Property Fund has declined to 1,160 local governments, or 43 fewer than at June 30, 2004. While some of the decline may be attributable to recent premium rate increases, OCI staff attribute the decrease to increased competition in the insurance market.

The recent decline in participation may have resulted from increased competition in the property insurance market.

Competition in the property insurance market may have increased in recent years as a result of 2003 Wisconsin Act 78, which took effect December 2003 and allows Wisconsin municipal mutual insurance carriers to sell property insurance. Before this change, municipal mutual carriers were allowed to offer only workers' compensation insurance, liability insurance, and risk management services. OCI should continue to monitor trends in Property Fund participation.

Destruction of Claim Files

From 1992 through 2001, OCI contracted with AON Risk Services (formerly Alexander & Alexander, Inc.), located in Green Bay, to administer the Property Fund. AON subcontracted with GAB Robins for claims processing, including ensuring claims were legitimate and maintaining documentation of the claims. GAB also made claim payments to local governments upon the approval of AON.

As of January 1, 2002, OCI contracted with a new private firm to administer the Property Fund.

In May 2001, OCI awarded the contract for administration of the Property Fund to a new administrator, ASU Group, which took over all aspects of administration on January 1, 2002. During the transition, AON sent Property Fund–related documentation such as procedural manuals and policyholder premium files to ASU Group. However, GAB continued to maintain all existing claim files and was responsible for completing the processing and following up on all claims that were reported before December 31, 2001.

In February 2004 nearly all claim files for FYs 2000-01 and 2001-02 were destroyed by a subcontractor of the previous fund administrator.

In conducting our audit fieldwork, we found that nearly all of the Property Fund claim files that were being maintained by GAB had been destroyed. GAB staff told us that a former employee destroyed most of the claim files in February 2004, believing they were no longer needed because a new administrator was taking over the contract to administer the Property Fund. OCI was not aware that the claim files had been destroyed until we made our request to review them. Both AON and GAB staff told us they did not authorize destruction of the files.

The claim files are important because they provide the documentation necessary to support paid claims. Destroying these files is a serious concern, and without this information the Audit Bureau could not provide an opinion on the Property Fund's financial statements.

The destruction of the claim files caused delays in the audit.

After learning of the destruction of the claim files and its implications for the audit opinion, OCI decided to pursue a process to re-create the destroyed files using information obtained from the local government participants in order to provide adequate documentation to support claims. The current fund administrator, ASU Group, coordinated the process of contacting local governments to obtain the needed information to support a proof of loss and the value of the damages. During the period OCI pursued the re-creation of the claim files, the audit was delayed. In addition to the delays in the audit, extra costs were incurred by local governments and OCI in re-creating the files, and by this office in completing our review of the files and gaining assurances on the accuracy of the claims paid. According to OCI, these extra costs will be paid by AON.

OCI should have taken additional steps to ensure that fund documentation was maintained.

During the transition to the new administrator, and again in February and April 2003, OCI discussed claim file retention with GAB staff. In February 2003, GAB indicated a need to maintain the claim files at its office to complete subrogation on some of the files. Nevertheless, OCI could have been expected to take additional steps after that point to ensure the claim files maintained by GAB were properly safeguarded, especially in light of the upcoming audit.

The claim files were destroyed in violation of existing state record-retention rules. We report the destruction of the claim files as a material weakness in internal controls. In addition, in a separate management letter we make recommendations that OCI include specific language in the contract with the fund administrator to cover the State's requirements for retaining Property Fund documents and that OCI take steps to ensure any additional claim files being maintained by AON and GAB be properly maintained by either having the files transferred to the current fund administrator or to OCI.

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Audit Opinion ▪

Independent Auditor's Report on the Financial Statements of the Wisconsin Local Government Property Insurance Fund

We have audited the accompanying financial statements of the Wisconsin Local Government Property Insurance Fund as of and for the years ended June 30, 2004, 2003, 2002, and 2001. These financial statements are the responsibility of the management of the Wisconsin Local Government Property Insurance Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2A, the financial statements referred to in the first paragraph present only the Wisconsin Local Government Property Insurance Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin Local Government Property Insurance Fund as of June 30, 2004, 2003, 2002, and 2001, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 8 to the financial statements, the Wisconsin Local Government Property Insurance Fund implemented Governmental Accounting Standards Board Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.*

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Local Government Property Insurance Fund. The supplementary information included as Management's Discussion and Analysis on pages 21 through 31 is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplementary information. However, we did not audit the information and express no opinion on it.

The Ten-Year Claims Development supplementary information included on pages 49 through 51 is not a required part of the financial statements referred to in the first paragraph, 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 14, 2005, on our consideration of the Wisconsin Local Government Property Insurance Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, 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 considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

October 14, 2005 by

Carolyn Stittleburg
Audit Director

Management's Discussion and Analysis ■

Prepared by Management of the Wisconsin Local Government Property Insurance Fund

Management's Discussion and Analysis is a required element of the financial reporting model adopted by the Governmental Accounting Standards Board (GASB). This section presents management's discussion and analysis of the financial performance of the Wisconsin Local Government Property Insurance Fund during the fiscal years ended June 30, 2004, 2003, 2002 and 2001. 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 Property Fund.

Overview of the Fund

The Property Fund is a segregated fund administered by the Office of the Commissioner of Insurance. Its purpose is to make reasonably priced property insurance available for local government property such as government buildings, schools, libraries, and motor vehicles. The Property Fund provides policy and claim service to the policyholders. It does not advertise and is not permitted to selectively underwrite risks. Otherwise, it operates like an insurance company by collecting premiums from its insureds and paying losses when they occur. It also incurs costs or expenses to underwrite policies and to adjust or settle loss claims.

Participation in the Property Fund is voluntary and requires that the local governmental unit submit an approved resolution authorizing coverage. A local governmental unit may terminate coverage at any time by a majority vote and by certifying such action to the Property Fund.

The Commissioner of Insurance acts as the Property Fund manager and is assisted by the Insurance Program Officer, who is a full-time OCI staff member. The Property Fund is administered by a contracted administrative company that maintains the Property Fund home office in Madison, Wisconsin. Several standing committees provide assistance to the Commissioner in the governance of the Property Fund.

The Oversight Committee consists of six members: four OCI staff members and two representatives from the Advisory Committee. This committee reviews recommendations on policy and procedures from the Advisory Committee and makes recommendations to the Commissioner as to the management and operational activities of the Property Fund. The Oversight Committee generally meets two times a year to formulate its recommendations to the Commissioner.

The Advisory Committee is a 21-member committee comprising representative members insured by the Property Fund. The Advisory Committee makes recommendations to the Oversight Committee on policies, rating, procedures, and items of members' interest regarding operations of the Property Fund. The Advisory Committee also meets two times a year. The Advisory Committee has established six subcommittees that include both members of the Advisory Committee and other policyholders. The current subcommittees are Mission Statement, Bylaws, Claims and Policy Issues, Rate Analysis, Loss Control, and Reinsurance and Flood.

The Property Fund operates on a July 1 through June 30 fiscal year basis. Administrative costs and operating costs, including claim payments, are funded through direct premiums from insured local governments. The Property Fund's insurance in force represents property that is insured against loss. To reduce insurance risk, the Property Fund purchases reinsurance through a reinsurance broker.

Financial Statements

The financial statements of the Property Fund have been prepared in accordance with generally accepted accounting principles. In the past two years, and most specifically in FY 2003-04, earned premiums have increased significantly in response to rating changes that were implemented over the past several years. Those premium increases, coupled with favorable loss experience in FY 2003-04, helped net assets, otherwise known as policyholder "surplus," to rebound after several years of decline.

Table A is a synopsis of key financial statistics for the past four years.

Table A

Key Financial Statistics
Fiscal Year Ended June 30

	2004	2003	2002	2001
Policies	1,203	1,206	1,183	1,133
Insurance in Force	$35.9 billion	$32.7 billion	$29.7 billion	$27.6 billion
Direct Premium Earned	$26,655,058	$17,239,514	$12,832,890	$11,354,966
Less Reinsurance Premiums Ceded	(5,710,491)	(4,602,006)	(2,815,158)	(2,349,941)
Net Premiums Earned	**$20,944,567**	**$12,637,508**	**$10,017,732**	**$ 9,005,025**
Direct Losses and Loss Expenses	$10,609,903	$18,576,153	$14,380,371	$14,781,080
Less Reinsurance Recoveries	(86,557)	(3,723,913)	(221,222)	(2,405,279)
Net Losses and Loss Expenses	**$10,523,346**	**$14,852,240**	**$14,159,149**	**$12,375,801**
Net Income (Loss)	$ 9,236,418	($ 2,483,591)	($ 3,553,756)	($ 2,078,946)
Fund Net Assets/Surplus	$24,501,139	$15,264,721	$17,748,312	$21,302,068

Policy Count and Insurance in Force

The Property Fund has provided a stable property insurance outlet for Wisconsin local governments for many years. Its policy count increased by 90 since FY 1999-2000. As of June 30, 2004, it insured 1,203 policyholders: 65 counties, 333 school districts, 170 cities, 224 towns, 283 villages, and 128 miscellaneous local governments such as libraries.

Recent changes in Wisconsin insurance laws now allow municipal mutual insurers in the state to write property insurance. As a result, the Property Fund lost seven county insureds and some automobile damage insurance. The number of policyholders decreased in FY 2003-04 by 3, which is a decline of 0.2 percent from the previous fiscal year-end.

Total insurance in force as of June 30, 2004, was $35.9 billion, up from $32.7 billion as of the previous fiscal year-end. The Property Fund's total insurance in force has increased by more than $2 billion each year. That growth is primarily due to the inflationary increases in the insurance property base and new construction.

Operating Revenues

As shown in Table B, operating revenues increased over the four-year period ended June 30, 2004.

Table B

Operating Revenues
Fiscal Year Ended June 30

	2004	2003	2002	2001
Operating Revenues	$21,200,474	$13,560,183	$11,683,575	$11,321,938
Change from Prior Year	56.3%	16.1%	3.2%	5.4%

The Property Fund's operating revenues consist of premiums from insured local governments, net of reinsurance premiums ceded, and investment income. All Property Fund insureds are billed annually. The building and contents line of insurance for the Property Fund's primary policy types use rates obtained annually for each insured from an independent insurance rating organization. Other lines of insurance use rates established by the Oversight Committee. Beginning in 2002, the Property Fund hired an independent actuarial firm to assist it with annual rate analyses. Rates are now established after considering input from the independent actuary and the Advisory Committee made up of policyholders and administrative support personnel.

In response to the decline in its net assets in FY 2000-01, the Property Fund implemented a 24 percent rate increase for the building and contents line of insurance effective July 1, 2001. The mandatory minimum deductible was also raised from $100 to $500. On July 1, 2002, the Property Fund implemented another 24 percent rate increase, this time across all lines of business. Effective January 1, 2003, it changed the building and contents loss cost multiplier from .74 to 1.00, began rating properties based on 100 percent of insured value instead of 90 percent, and adjusted all policyholder loss costs to reflect current Insurance Services Office loss costs. The impact of those three actions was an average overall increase of 90 percent in the building and contents line for FY 2003-04 rates.

As a result of the rate increases and increases in insured values, earned premiums have increased significantly over the past three years. The full impact of rating increases routinely takes 24 months to fully show up in operational results, as insureds renew throughout the year and rating changes are applied effective upon renewal.

Investment income includes bond interest and capital gains and losses. The Property Fund's investment strategy is to invest primarily in high-grade fixed-income securities that have a reasonable degree of safety of principal and income-paying ability. High priority is given to matching the maturity of assets with the liquidity needs of the liabilities.

Operating Expenses

Operating expenses represent four categories: loss and loss adjustment expenses, contracted services, personnel, and other expenses. The Property Fund's largest operating expenses consist of loss and loss adjustment expenses paid plus changes to the loss liabilities. As shown in Table C, operating expenses increased from FY 2000-01 through FY 2002-03, primarily because of increases in claims, including significant claims from major storms. Weather-related claims were 25.8 percent of FY 2000-01 claims, 13.7 percent of FY 2001-02 claims, and 35.1 percent of FY 2002-03 claims.

Table C

Operating Expenses
Fiscal Year Ended June 30

	2004	2003	2002	2001
Operating Expenses	$11,964,056	$16,043,774	$15,237,331	$13,400,884
Change from Prior Year	-25.4%	5.3%	13.7%	50.3%

Loss expenses can vary widely depending both on claims paid and upon claims reported during any given year. Further, loss expenses are affected by the changes to the loss liabilities, which can be either positive or negative depending upon changes in the reserves and estimated losses incurred but not reported. Any reinsurance loss recoveries are netted in loss expense. Net loss and loss expenses were as follows:

- $10.5 million in FY 2003-04 (a ratio of 50 percent of net premiums earned);
- $14.9 million in FY 2002-03 (a ratio of 118 percent of net premiums earned);

- $14.1 million in FY 2001-02 (a ratio of 141 percent of net premiums earned); and
- $12.4 million in FY 2000-01 (a ratio of 137 percent of net premiums earned).

The other categories of operating expenses noted above were as follows:

- $1.4 million in FY 2003-04 (a ratio of 7 percent of net premiums earned);
- $1.2 million in FY 2002-03 (a ratio of 9 percent of net premiums earned);
- $1.1 million in FY 2001-02 (a ratio of 11 percent of net premiums earned); and
- $1.0 million in FY 2000-01 (a ratio of 11 percent of net premiums earned).

The reduction in the other operating expense ratio resulted primarily from the increase in net premium earned, which followed the premium rate increases.

Net Income (Loss)

Net income (loss) represents the difference between operating revenue and operating expenses. By FY 2003-04, the effects of rating changes adopted from FY 2000-01 through FY 2002-03 had been fully implemented, resulting in positive net income for FY 2003-04, as shown in Table D.

Table D

Net Income (Loss)
Fiscal Year Ended June 30

	2004	2003	2002	2001
Net Income (Loss)	$9,236,418	($2,483,591)	($3,553,756)	($2,078,946)

Assets

The Property Fund's assets consist primarily of investments in bonds and the State of Wisconsin Investment Pool, which is classified as a cash equivalent on the financial statements. The investments are managed by the State of Wisconsin Investment Board (SWIB) in accordance with state statutes. The Property Fund's Oversight Committee provides additional guidance. SWIB has been instructed to invest a portion of the cash equivalents in long-term bonds as market conditions warrant. Other assets include reinsurance recoverable on paid claims, premiums receivable from insureds, and accrued investment income. Table E shows total assets over the four-year period ended June 30, 2004. Total assets increased more than $4.6 million, or 14.5 percent, from the beginning of FY 2000-01 through the end of FY 2003-04.

Table E

Assets
Fiscal Year Ended June 30

	2004	2003	2002	2001
Total Assets	$36,371,361	$28,887,761	$28,848,378	$33,927,000
Change from Prior Year	25.9%	0.1%	-15.0%	6.8%

Liabilities

Total liabilities have increased by 41.7 percent since FY 1999-2000. As an insurance entity, the Property Fund's primary liabilities are unpaid loss liabilities and deferred revenue (unearned premiums), which are recorded net of corresponding reinsurance. Table F shows total liabilities over the four-year period ended June 30, 2004.

Table F

Liabilities
Fiscal Year Ended June 30

	2004	2003	2002	2001
Total Liabilities	$11,870,222	$13,623,040	$11,100,066	$12,624,932
Change from Prior Year	-12.9%	22.7%	-12.1%	50.7%

The loss liabilities include amounts for individual case estimates for reported losses, as well as estimates for incurred but not reported losses. Loss liabilities also include a provision for the estimated future payment of claim adjustment costs associated with the outstanding claims. The loss liabilities are the amounts expected to be paid in the future for incidents that have already occurred. The loss liabilities can fluctuate based on whether there are significant windstorm claims open at year-end or any major open fire losses. The change in deferred revenue fluctuates with changes in premiums written and reinsurance ceded. Table G displays the changes by year in those primary liabilities, as well as the percentage of total liabilities that each primary liability represents.

Table G

Changes in Primary Liabilities
For the Year Ended June 30

	2004	2003	2002	2001
Net Unpaid Loss Liabilities	$4,354,492	$5,710,065	$7,067,472	$8,338,604
Change from Prior Year	-23.7%	-19.2%	-15.2%	143.6%
Deferred Revenue (Net Unearned Premiums)	$6,702,224	$6,964,671	$3,328,130	$3,521,654
Change from Prior Year	-3.8%	109.3%	-5.5%	-22.2%
Net Unpaid Loss Liabilities and Net Unearned Premiums	$11,056,716	$12,674,736	$10,395,602	$11,860,258
Percentage of Total Liabilities	93.1%	93.0%	93.7%	93.9%

Excess of Loss (Reinsurance) Program

To transfer insurance risk, the Property Fund purchases excess of loss (reinsurance) coverage in the commercial market. There have been significant changes in the Property Fund's reinsurance program since FY 1999-2000. Catastrophic property insurance claims from the events of September 11, 2001, and large storm and wind-related claims from other parts of the country affected reinsurance premiums paid by all participants in that market. The Property Fund also experienced significant losses during that time period.

Table H summarizes the Property Fund's Excess of Loss Program from July 1, 2000, to the present.

Table H

Reinsurance Terms

Period Covered	Per Risk Occurrence Retention	Aggregate Retention	Aggregate Limit	Aggregate Underlying per Claim Deductible	Aggregate Maintenance Deductible
7/1/2000–12/31/2000	$ 500,000	$ 3,000,000	$240 million	$2,500	$10,000
1/1/2001–11/30/2001	2,000,000	11,000,000	240 million	2,500	10,000
12/1/2001–12/31/2002	2,000,000	13,000,000	240 million	5,000	10,000
1/1/2003–12/31/2003	2,000,000	18,000,000	240 million	5,000	10,000
1/1/2004–3/31/2004	2,000,000	4,500,000	325 million	5,000	10,000
3/31/2004–3/31/2005	2,000,000	18,000,000	325 million	5,000	10,000
3/31/2005–3/31/2006	2,000,000	18,000,000	375 million	5,000	10,000

The Property Fund had received unusual surplus relief under its reinsurance program by paying much less in premiums than it received in loss recoveries, as illustrated in Table I.

Table I

Reinsurance Premiums versus Reinsurance Loss Recoveries

Fiscal Year Ended June 30	Reinsurance Premiums	Reinsurance Loss Recoveries	Outflow to (Inflow from) Reinsurers
1995	$ 1,460,298	$ 0	$ 1,460,298
1996	1,358,900	2,215,057	(856,157)
1997	1,678,182	2,036,322	(358,140)
1998	1,875,304	7,957,396	(6,082,092)
1999	1,023,219	5,423,057	(4,399,838)
2000	1,055,074	5,856,128	(4,801,054)
Subtotal	**$ 8,450,977**	**$23,487,960**	**$(15,036,983)**
2001	$ 2,349,941	$ 2,405,279	$ (55,338)
2002	2,815,158	221,222	2,593,936
2003	4,602,006	3,723,913	878,093
2004	5,710,491	86,557	5,623,934
Subtotal	**$15,477,596**	**$ 6,436,971**	**$ 9,040,625**
Total	**$23,928,573**	**$29,924,931**	**$ (5,996,358)**

Because of large losses and the potential cancellation of its reinsurance program, the Property Fund agreed to accept higher retentions and increased reinsurance premiums. However, by taking a higher self-insured retention, it is increasingly bearing more of the losses formerly ceded to reinsurers. Premiums were adjusted to reflect the increased risk, as explained in management's discussion and analysis of operating revenues.

Net Assets (Surplus)

The Property Fund's net assets represent the excess of assets over liabilities. Changes in its net assets, known as surplus, are attributable to the difference between revenues and expenses, that is, its net income. The surplus increased from $15.3 million to $24.5 million in FY 2003-04 as a result of higher premium revenue and lower losses than in prior years. This follows a three-year period from June 30, 2000, to June 30, 2003, in which net assets had declined by a total of $8,116,293. Table J summarizes the change in the Property Fund's surplus over the four-year period ended June 30, 2004.

Table J

Net Assets (Surplus)
Fiscal Year Ended June 30

	2004	2003	2002	2001
Fund Net Assets	$24,501,139	$15,264,721	$17,748,312	$21,302,068
Change from Prior Year	60.5%	-14.0%	-16.7%	-8.9%

The Property Fund operates under a plan to maintain its surplus at a level consistent with the insurance exposures in force and considers size of net risk retained after reinsurance and annual premium written. The Property Fund also strives to smooth any rate changes over time to avoid large fluctuations in premiums charged to local units of government.

Subsequent Events

Fund losses have stabilized over the past two years and, combined with the fully recognized impact of rate increases, restored the Property Fund surplus to a more appropriate level. Premiums have been adjusted downward for the period beginning July 1, 2005, based on actuarial recommendations.

The Property Fund is also in the process of having a probable maximum loss (PML) study completed, which will help management evaluate the current reinsurance program.

Summary

The Property Fund continues to operate for its stated purpose of making reasonably priced property insurance available for local units of government. It will continue to monitor its fund surplus and adjust rates accordingly. Factors that will influence future rates will focus on changes to the net assets and the structure, cost, and availability of excess of loss (reinsurance) coverage.

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Financial Statements

Balance Sheet
June 30, 2004, 2003, 2002, and 2001

	June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001
ASSETS				
Current Assets:				
Cash and cash equivalents (Notes 2 and 3)	$ 24,113,013	$ 11,627,517	$ 12,022,608	$ 11,187,564
Receivables:				
Due from policyholders	1,062,674	3,102,743	717,253	804,042
Other receivables	187,802	246,249	306,857	400,190
Reinsurance recoverable on paid claims (Notes 2 and 5)	2,902,421	1,493,357	348,256	1,854,871
Total Receivables	4,152,897	4,842,349	1,372,366	3,059,103
Total Current Assets	28,265,910	16,469,866	13,394,974	14,246,667
Noncurrent Assets:				
Investments (Note 3)	8,105,451	12,417,895	15,453,404	19,680,333
TOTAL ASSETS	$ 36,371,361	$ 28,887,761	$ 28,848,378	$ 33,927,000
LIABILITIES AND NET ASSETS				
Current Liabilities:				
Unpaid loss liabilities (Notes 2, 4, and 5)	$ 4,354,492	$ 5,710,065	$ 7,067,472	$ 8,338,604
Deferred revenue for unearned premiums	6,702,224	6,964,671	3,328,130	3,521,654
Accounts payable and other accrued liabilities	811,204	945,973	702,165	763,130
Due to State of Wisconsin	2,302	2,331	2,299	1,544
Total Current Liabilities	11,870,222	13,623,040	11,100,066	12,624,932
Net Assets:				
Restricted for fund purposes	24,501,139	15,264,721	17,748,312	21,302,068
TOTAL LIABILITIES AND NET ASSETS	$ 36,371,361	$ 28,887,761	$ 28,848,378	$ 33,927,000

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Assets for the Years Ended June 30, 2004, 2003, 2002, and 2001

	Year Ended June 30, 2004	Year Ended June 30, 2003	Year Ended June 30, 2002	Year Ended June 30, 2001
OPERATING REVENUES				
Net Premiums Earned (Notes 2 and 5)	$ 20,944,567	$ 12,637,508	$ 10,017,732	$ 9,005,025
Investment Income	255,907	921,623	1,665,550	2,315,139
Other Income	0	1,052	293	1,774
Total Operating Revenues	**21,200,474**	**13,560,183**	**11,683,575**	**11,321,938**
OPERATING EXPENSES				
Losses and Loss Expenses (Notes 2 and 5)	10,523,346	14,852,240	14,159,149	12,375,801
Contracted Services	1,124,267	888,408	856,575	789,830
Personnel Services	88,379	71,397	79,142	66,531
Other Expenses	228,064	231,729	142,465	168,722
Total Operating Expenses	**11,964,056**	**16,043,774**	**15,237,331**	**13,400,884**
Net Income (Loss)	**9,236,418**	**(2,483,591)**	**(3,553,756)**	**(2,078,946)**
Net Assets, Beginning of the Year	15,264,721	17,748,312	21,302,068	23,381,014
Net Assets, End of the Year	**$ 24,501,139**	**$ 15,264,721**	**$ 17,748,312**	**$ 21,302,068**

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2004, 2003, 2002, and 2001

	Year Ended June 30, 2004	Year Ended June 30, 2003	Year Ended June 30, 2002	Year Ended June 30, 2001
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash Received for Premiums	$ 22,549,853	$ 14,103,634	$ 9,913,605	$ 10,486,613
Losses and Loss Expenses Paid	(13,287,983)	(17,354,747)	(13,923,667)	(9,303,953)
Cash Payments for Contracted Services	(1,219,849)	(989,631)	(870,981)	(561,331)
Cash Payments to Employee for Services	(110,474)	(89,246)	(79,142)	(66,531)
Other Operating Revenues (Expenses)	(72,849)	(82,840)	(190,584)	(126,803)
Net Cash Provided (Used) by Operating Activities	**7,858,698**	**(4,412,830)**	**(5,150,769)**	**427,995**
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from Sale and Maturities of Investments	3,750,000	3,000,000	4,525,513	6,907,511
Investment Income Received	876,798	1,017,739	1,460,300	1,471,572
Purchase of Investments	0	0	0	(14,138,777)
Net Cash Provided (Used) by Investing Activities	**4,626,798**	**4,017,739**	**5,985,813**	**(5,759,694)**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**12,485,496**	**(395,091)**	**835,044**	**(5,331,699)**
Cash and Cash Equivalents at the Beginning of the Year	11,627,517	12,022,608	11,187,564	16,519,263
Cash and Cash Equivalents at the End of the Year	$ 24,113,013	$ 11,627,517	$ 12,022,608	$ 11,187,564

The accompanying notes are an integral part of this statement.

RECONCILIATION OF NET OPERATING INCOME TO NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES	Year Ended June 30, 2004	Year Ended June 30, 2003	Year Ended June 30, 2002	Year Ended June 30, 2001
Net Income (Loss)	$ 9,236,418	$ (2,483,591)	$ (3,553,756)	$ (2,078,946)
Adjustments to Reconcile Net Income to Net Cash and Cash Equivalents Provided by Operating Activities:				
Operating income (investment income) classified as investing activity	(255,907)	(921,623)	(1,665,550)	(2,315,138)
Changes in assets and liabilities:				
Decrease (Increase) in Due from policyholders	2,040,069	(2,385,490)	86,789	204,265
Decrease (Increase) in reinsurance recoverable	(1,409,064)	(1,145,100)	1,506,614	(1,843,277)
Decrease (Increase) in ceded reinsurance premiums paid in advance	0	0	0	2,215,484
Increase (Decrease) in accounts payable and other accrued liabilities	(134,769)	243,808	(60,965)	335,707
Increase (Decrease) in deferred revenue for unearned premiums	(262,447)	3,636,541	(193,524)	(1,004,618)
Increase (Decrease) in unpaid loss liabilities	(1,355,573)	(1,357,407)	(1,271,132)	4,915,125
Increase (Decrease) in Due to State of Wisconsin	(29)	32	755	(607)
Total Adjustments	(1,377,720)	(1,929,239)	(1,597,013)	2,506,941
Net Cash and Cash Equivalents Provided (Used) by Operating Activities	**$ 7,858,698**	**$ (4,412,830)**	**$ (5,150,769)**	**$ 427,995**
Noncash Investing, Capital, and Financing Activities:				
Net change in unrealized gains and losses	$ (542,618)	$ (2,979)	$ 317,977	$ 565,114

The accompanying notes are an integral part of this statement.

Notes to the 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. Its purpose 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 non–state 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, mold, war, nuclear reaction, and embezzlement or theft by an employee. 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 Property Fund bears the risk of loss for property covered by the policies, subject to policy deductibles that vary from $100 to $100,000 per claim. Policyholders are not subject to any premium assessments should a premium deficiency exist. For this and other reasons, the Property Fund's 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.

The Property Fund is managed by the Office of the Commissioner of Insurance, which contracts with a private company for administration.

Participation in the Property Fund, along with total insurance in force for FYs 2000-01 through 2003-04, can be seen in the table that follows.

	June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001
Counties	65	72	72	71
Cities	170	165	161	151
Towns	224	257	270	282
Villages	283	260	246	220
School Districts	333	334	323	296
Other	128	118	111	113
Total	1,203	1,206	1,183	1,133
Insurance in Force	$35.9 billion	$32.7 billion	$29.7 billion	$27.6 billion

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying financial statements of the Property Fund have been prepared in conformity with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB). These statements present the financial position and results of operations of only the activity of the Property Fund and are not intended to present the financial activity for the State of Wisconsin as a whole.

B. Basis of Accounting

The accompanying financial statements were prepared based upon the flow of economic resources measurement focus and the 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. The Property Fund applies all applicable GASB pronouncements. 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 could differ from those estimates. Estimates that are particularly susceptible to significant change in future years 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

All cash is deposited with the State of Wisconsin Treasurer and is required to be invested in the State Investment Fund. 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. Since shares in the State Investment Fund are purchased in $1,000 increments, cash balances below $1,000 are deposited in the State's bank.

E. Investment Valuation

Investments of the Property 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 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 liabilities 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 periods in which the estimates are charged or payments are made.

H. Reinsurance

The Property Fund purchases excess-of-loss reinsurance to reduce its exposure to large losses on all types of insured events. Premiums ceded to reinsurers decrease charges for earned premiums on the Statement of Revenues, Expenses, and Changes in Net Assets. Reinsurance loss and loss adjustment expense recoveries earned for the year decrease losses and loss expenses on the Statement of Revenues, Expenses, and Changes in Net Assets. Reinsurance recoverable on paid losses is included in other receivables and reinsurance recoverable on unpaid losses decreases unpaid loss liabilities on the Balance Sheet. Further detail on reinsurance coverage is disclosed in Note 5.

I. 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.

J. Employee Compensated Absences

The Property Fund's compensated absence liability consists of accumulated unpaid leave, compensatory time, personal holiday hours, and Saturday/legal holiday hours earned and vested as of June 30. Compensated absences liability was $0 in FY 2000-01, $11,500 in FY 2001-02, $12,750 in FY 2002-03, and $12,675 in FY 2003-04.

3. DEPOSITS AND INVESTMENTS

A. Deposits

All cash is deposited with the State of Wisconsin and is invested by the State of Wisconsin Investment Board through the State Investment Fund. The State Investment Fund is not registered with the 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), and (bd), Wis. Stats. Holdings of the State Investment Fund include certificates of deposit and investments consisting primarily of direct obligations of the federal government and the State, and unsecured notes of financial and industrial issuers. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The fair value of shares in the State Investment Fund was $24,096,281 as of June 30, 2004; $11,452,754 as of June 30, 2003; $12,021,739 as of June 30, 2002; and $11,162,386 as of June 30, 2001. 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 Section 25.17(1)(jm), Wis. Stats, all of the Property Fund's investments are managed by the State of Wisconsin Investment Board, with the investment objectives to invest monies held in the Property 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. The amortized cost and fair values of the Property Fund's fixed-income obligations at fiscal year-end are as follows:

Fiscal Year Ended	Amortized Cost	Fair Value
June 30, 2004	$ 7,830,497	$ 8,105,451
June 30, 2003	11,600,323	12,417,895
June 30, 2002	14,632,853	15,453,404
June 30, 2001	19,177,759	19,680,333

All of 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 by its agent in the State's name.

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 four fiscal years.

	Fiscal Year Ended June 30 (In Thousands)			
	2004	2003	2002	2001
Unpaid Loss Liabilities at Beginning of Year	$12,178	$11,773	$14,436	$11,890
Less: Reinsurance Recoverable	(6,468)	(4,706)	(6,097)	(8,466)
Net Unpaid Loss Liabilities at Beginning of Year	5,710	7,067	8,339	3,424
Incurred Losses and Loss Adjustment Expenses:				
Provision for insured events of the current year	11,118	14,406	13,858	13,050
Increase (decrease) in provision for insured events of prior years	(595)	446	301	(675)
Total Incurred Losses and Loss Adjustment Expenses	10,523	14,852	14,159	12,375
Payments[1]:				
Losses and loss adjustment expenses attributable to insured events of the current year	7,139	9,040	7,278	5,060
Losses and loss adjustment expenses attributable to insured events of prior years	4,740	7,169	8,153	2,400
Total Payments	11,879	16,209	15,431	7,460
Unpaid Loss Liabilities at End of Year	4,354	5,710	7,067	8,339
Plus: Reinsurance Coverage	3,652	6,468	4,706	6,097
Total Loss Liabilities at End of Year	$ 8,006	$12,178	$11,773	$14,436

[1] Payments include the change in reinsurance recoverable on paid losses and drafts outstanding of $1,409,064 in FY 2003-04; $1,145,101 in FY 2002-03; ($1,506,615) in FY 2001-02; and $1,843,277 in FY 2000-01.

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 following table shows the reinsurance retentions, deductibles, and limits for the reinsurance terms in force during the four years of these financial statements. For the aggregate reinsurance contracts, only claims over the underlying per claim deductible are included in the aggregate calculation, and once the aggregate retention is met, only claim occurrences over $10,000 are included in the recoverable calculation.

Reinsurance Term	Per Risk Occurrence Retention	Aggregate Retention	Aggregate Limit	Aggregate Underlying per Claim Deductible
7/1–12/31/2000	$ 500,000	$ 3,000,000	$240 million	$2,500
1/1–11/30/2001	2,000,000	11,000,000	240 million	2,500
12/1/2001–12/31/2002	2,000,000	13,000,000	240 million	5,000
1/1–12/31/2003	2,000,000	18,000,000	240 million	5,000
1/1–3/31/2004	2,000,000	4,500,000	325 million	5,000
3/31/2004–3/31/2005	2,000,000	18,000,000	325 million	5,000

Premiums ceded to reinsurers decrease charges for earned premiums on the Statement of Revenues, Expenses, and Changes in Net Assets. The following table presents total premiums, reinsurance premiums ceded, and net premiums earned.

	For the Year Ended June 30			
	2004	2003	2002	2001
Total Premiums	$26,655,058	$17,239,514	$12,832,890	$11,354,966
Less Reinsurance Premiums Ceded	5,710,491	4,602,006	2,815,158	2,349,941
Net Premiums Earned	$20,944,567	$12,637,508	$10,017,732	$ 9,005,025

Reinsurance loss and loss adjustment expense recoveries earned for the year decrease losses and loss expenses on the Statement of Revenues, Expenses, and Changes in Net Assets. The following table presents total loss and loss expenses, losses recovered through reinsurance, and net loss and loss expenses.

	For the Year Ended June 30			
	2004	2003	2002	2001
Total Losses and Loss Expenses	$10,609,903	$18,576,153	$14,380,371	$14,781,080
Less Losses Recovered through Reinsurance	86,557	3,723,913	221,222	2,405,279
Net Losses and Loss Expenses	$10,523,346	$14,852,240	$14,159,149	$12,375,801

Reinsurance recoverable on unpaid losses decreases unpaid loss liabilities on the Balance Sheet. The following table presents total unpaid loss liabilities, estimated reinsurance recoverable, and net unpaid loss liabilities.

	For the Year Ended June 30			
	2004	2003	2002	2001
Unpaid Loss Liabilities	$8,006,682	$12,178,119	$11,772,988	$14,435,710
Less Estimated Reinsurance Recoverable	3,652,190	6,468,054	4,705,516	6,097,106
Net Unpaid Loss Liabilities	$4,354,492	$ 5,710,065	$ 7,067,472	$ 8,338,604

6. PENSION PLAN

The permanent, full-time employee of the Property Fund is a participant in the Wisconsin Retirement System, 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 employee's 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.

The Wisconsin Retirement System 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 may be obtained by writing to:

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

The report is also available on the Department of Employee Trust Funds' Web site, *http://etf.wi.gov.*

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 Wisconsin Retirement System. Prior service costs are amortized over 40 years, beginning January 1, 1990. However, in December 2003, the State issued bonds and subsequently fully liquidated its prior service liability balance as of January 2003. The liquidation of the State's prior service liability resulted in credits being granted to state agencies for amounts already paid in 2003. In addition, state agencies will be required to make future contributions to fund the bond payments.

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 the Wisconsin Retirement System is not available since the Wisconsin Retirement System is a statewide, multiple-employer plan.

7. STATUTORY REPORTING

Like private insurance companies doing business in Wisconsin, the Property Fund files an annual financial statement with the State of Wisconsin Office of the Commissioner of Insurance. 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 statutory and GAAP net assets and net income (loss) in the table that follows is a result of recording investments and cash equivalents at market value under GAAP and at cost or amortized cost under statutory accounting.

	Net Assets		Net Income(Loss)	
Fiscal Year	Statutory	GAAP	Statutory	GAAP
2004	$24,268,328	$24,501,139	$9,793,162	$9,236,418
2003	14,475,165	15,264,721	(2,472,109)	(2,483,591)
2002	16,947,274	17,748,312	(3,871,952)	(3,553,756)
2001	20,819,224	21,302,068	(2,682,068)	(2,078,946)

8. CHANGE IN ACCOUNTING PRINCIPLE

The Property Fund implemented a new financial reporting model for FYs 2000-01 through 2003-04, as required by the provisions of GASB Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. The primary changes under GASB Statement 34 were the reclassification of retained earnings to net assets and presentation of management's discussion and analysis.

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Required Supplementary Information

The table on page 51 illustrates how the Property Fund's earned revenue (net of reinsurance) compares 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 from End of Policy Year—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.

Ten-Year Claims Development Information

Fiscal Policy Year Ended June 30
(In Thousands)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1. Premiums and Investment Revenue:										
Earned	$ 9,982	$ 10,347	$ 10,633	$ 11,241	$ 11,396	$ 11,801	$ 13,578	$ 14,518	$ 18,190	$ 26,920
Ceded	1,460	1,359	1,678	1,875	1,023	1,055	2,258	2,815	4,602	5,710
Net Earned	8,522	8,988	8,955	9,366	10,373	10,746	11,320	11,703	13,588	21,210
2. Unallocated Expenses	211	112	266	1,854	604	536	621	652	477	210
3. Estimated Incurred Claims and Expenses, as of End of Policy Year:										
Incurred	4,427	9,402	8,431	16,828	12,543	16,134	14,125	14,837	18,589	11,118
Ceded	0	1,600	1,328	8,515	4,127	7,881	1,075	979	4,183	0
Net Incurred	4,427	7,802	7,103	8,313	8,416	8,253	13,050	13,858	14,406	11,118
4. Net Paid (Cumulative) as of:										
End of policy year	2,489	3,376	405	4,561	4,206	4,866	5,060	7,278	9,040	7,138
One year later	4,493	6,956	5,880	7,979	7,452	7,344	12,333	13,669	12,431	
Two years later	4,604	6,667	6,361	8,173	7,714	8,088	13,459	14,814		
Three years later	4,604	6,763	6,385	8,620	7,714	7,741	13,492			
Four years later	4,604	6,763	6,460	8,620	7,714	7,760				
Five years later	4,604	6,809	6,460	8,620	7,714					
Six years later	4,604	6,809	6,460	8,620						
Seven years later	4,604	6,809	6,460							
Eight years later	4,604	6,809								
Nine years later	4,604									
5. Reestimated Ceded Losses and Expenses	0	2,150	1,020	8,339	3,544	8,752	632	316	4,633	0
6. Reestimated Net Incurred Claims and Expenses:										
End of policy year	4,427	7,802	7,103	8,313	8,416	8,253	13,050	13,858	14,406	11,118
One year later	4,674	7,095	6,357	8,180	7,785	7,692	12,773	14,014	12,722	
Two years later	4,604	6,801	6,393	8,620	7,714	8,135	13,459	14,898		
Three years later	4,604	6,763	6,460	8,620	7,714	7,741	13,492			
Four years later	4,604	6,763	6,460	8,620	7,714	7,760				
Five years later	4,604	6,809	6,460	8,620	7,714					
Six years later	4,604	6,809	6,460	8,620						
Seven years later	4,604	6,809	6,460							
Eight years later	4,604	6,809								
Nine years later	4,604									
7. Increase/Decrease in Estimated Incurred Claims and Expenses from End of Policy Year	$ 177	$ (993)	$ (643)	$ 307	$ (702)	$ (493)	$ 442	$ 1,040	$ (1,684)	$ 0

Report on Control and Compliance ▪

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the Wisconsin Local Government Property Insurance Fund as of and for the years ended June 30, 2004, 2003, 2002, and 2001 and have issued our report thereon dated October 14, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Wisconsin 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 an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Wisconsin Local Government Property Insurance Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. As discussed in the report section titled "Destruction of Claim Files," we report that nearly all claim files for FYs 2000-01 and 2001-02 were prematurely destroyed. OCI did not take the necessary steps to ensure records were maintained after the change in fund administrators. As a result, OCI did not initially have adequate documentation to support claim payments. OCI did take steps to re-create the documentation to be able to support its assertions related to the claims paid, which allowed us to be able to provide an unqualified opinion on the financial statements.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the basic 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described in the preceding paragraph is a material weakness.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Wisconsin Local Government Property Insurance Fund's financial statements are free of material misstatement, we performed tests of its 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*.

We noted certain additional matters that we reported to the management of the Wisconsin Local Government Property Insurance Fund in a separate letter dated October 27, 2005.

This independent auditor's report is intended for the information and use of the Wisconsin Local Government Property Insurance Fund's management and the Wisconsin Legislature. This independent auditor's report, 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 internal control over financial reporting or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

Carolyn Stittleburg

October 14, 2005 by

Carolyn Stittleburg
Audit Director

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

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October 19, 2005

Janice Mueller
State Auditor
Legislative Audit Bureau
22 E. Mifflin St. Ste. 500
Madison WI 53703

Dear Ms. Mueller:

Thank you for the opportunity to review and comment on the draft report and management letter for the recently completed audit of the Local Government Property Insurance Fund.

As we have discussed, the Office of the Commissioner of Insurance (OCI), continues to have concerns about the audit findings related to the unauthorized destruction of claim records by the previous administrative services contractor (AON/GAB). The finding recommends "OCI should have taken additional steps to ensure that fund documentation was maintained." The contract between OCI and AON/GAB required that state record retention procedures were to be followed. As documented in the audit, between the transition date of January 2002 and the records destruction in February 2004, OCI on at least 3 occasions, reminded AON/GAB of their contractual obligations to retain records. OCI staff conducted an on-site visit in 2003 to review documentation in claim files, verifying that the files still existed. We are unclear as to what additional steps could have been taken to prevent willful records destruction.

Under the terms of the contract, AON/GAB continued to be responsible for and had been paid for adjudicating claims, including subrogation, that were filed prior to January 1, 2002. There was a legitimate business reason to allow the files to remain with them during claim run-off. A decision by OCI to take possession of the files could have resulted in OCI paying a second contractor to adjudicate outstanding claims.

Neither OCI nor either of contractors involved wants to minimize the significance of this event. The Fund has implemented additional contract obligations, requiring the administrator to seek OCI approval prior to any records destruction and annually retrain staff on record retention requirements. We will also be evaluating the scanning and electronic retention of documents to prevent any future recurrence.

Thank you again for the opportunity to comment on the draft report. OCI appreciates the willingness of your staff to work with us to resolve the issues uncovered during the audit, and we would be happy to consider any specific recommendations you may have on safeguarding records.

Sincerely,

Eileen Mallow

Eileen Mallow
Assistant Deputy Commissioner

cc: Dan Bubolz, Insurance Program Officer