Report 09-6
June 2009

An Audit

Local Government Property Insurance Fund

Office of the Commissioner of Insurance

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Janice Mueller
State Auditor

June 3, 2009

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Vinehout and Representative Barca:

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, 2008, it insured $45.5 billion in property owned by 1,124 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, 2008, 2007, 2006, and 2005.

The Property Fund's surplus balance, or net assets available to pay future claims, has increased by $12.2 million since June 30, 2004, and by the end of FY 2007-08 it had reached $36.7 million. Therefore, the Property Fund began to reduce rates beginning July 1, 2005. OCI monitors premium rates and the surplus balance and believes both are appropriate in light of recent loss experience and its reinsurance program. We include a recommendation that OCI continue to monitor the Property Fund's surplus.

We question some of OCI's practices for charging expenses to the Property Fund's administration and operations appropriations, especially expenses related to a new computer system implemented in 2004. We include a recommendation that costs be charged in accordance with an approved and consistent methodology.

Finally, we note financial reporting concerns that are discussed in the Report on Control and Compliance included in this report.

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

Respectfully submitted,

Janice Mueller

Janice Mueller
State Auditor

JM/CS/ss

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.

The Office of the Commissioner of Insurance (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 participating local governments, and the Oversight Committee, which consists of OCI staff and representatives of the Advisory Committee.

In June 2008, the Property Fund insured $45.5 billion in property owned by 1,124 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 1, the Property Fund insured 1,124 local units of government in June 2008, and insured property was valued at $45.5 billion.

Table 1

Number and Type of Policyholders
As of June 30

Governmental Unit	2005	2006	2007	2008
Counties	63	62	62	62
Cities	162	162	160	158
Towns	220	212	202	191
Villages	269	269	274	274
School Districts	326	326	326	319
Other	120	125	123	120
Total	**1,160**	**1,156**	**1,147**	**1,124**
Insurance in Force (in billions)	$37.2	$39.9	$42.8	$45.5

Despite decreases in the number of governmental units insured with the Property Fund, the value of insurance in force has continued to increase as a result of both inflationary increases in the property base and of new construction.

Financial Status

The Property Fund ended FY 2007-08 with a surplus of $36.7 million.

Local governments that participate in the Property Fund pay annual premiums based on the value of their insured property. Premiums are generally expected to be sufficient to pay policyholder claims over the long term. Premiums and investment earnings in excess of policyholder claims allow the Property Fund to accumulate a surplus balance, which is net assets available to pay future claims. As shown in Table 2, the surplus balance has increased by $12.2 million since June 30, 2004, and by the end of fiscal year (FY) 2007-08, it had reached $36.7 million.

Table 2

Surplus Balance[1]
As of June 30

Fiscal Year	Increase (Decrease)	Surplus Balance
2003-04	$ 9,236,418	$24,501,139
2004-05	10,016,387	34,517,526
2005-06	4,226,249	38,743,775
2006-07	2,177,018	40,920,793
2007-08	(4,259,600)	36,661,193

[1] Reflected as net assets on the financial statements.

The increase in surplus is primarily attributable to premium rate increases that were implemented prior to FY 2003-04. Higher premium rates, along with fewer claims than anticipated, led to a $9.2 million increase in net assets in FY 2003-04 and a $10.0 million increase in net assets in FY 2004-05. The Property Fund therefore began to reduce rates effective July 1, 2005.

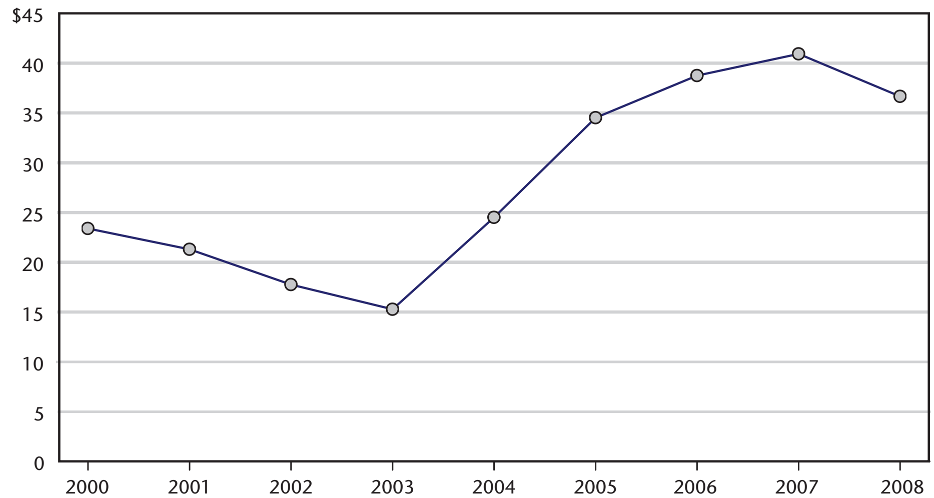
The Property Fund experienced its highest claim levels to date from FY 2005-06 through FY 2007-08.

Over the next three years, the Property Fund experienced its highest claim levels to date, largely because of a significant number of weather-related incidents and other large claims, combined with increased building replacement costs. The Property Fund purchases excess-of-loss insurance, which is analogous to reinsurance, to help limit its exposure to these types of large losses. Total claims, including those paid by reinsurance, were $18.4 million in FY 2005-06, $23.3 million in FY 2006-07, and $24.0 million in FY 2007-08.

Premium and investment income was sufficient to cover the Property Fund's share of claims in FY 2005-06 and FY 2006-07. As a result, the Property Fund's surplus continued to increase and as shown in Figure 1, reached a high of $40.9 million as of June 30, 2007. As of June 30, 2008, the surplus had declined to $36.7 million.

Figure 1

Surplus Balance
For the Fiscal Year Ended June 30
(in millions)



Monitoring the Surplus

Monitoring the surplus is important to ensure the continued financial stability of the Property Fund.

Monitoring the surplus is important to ensuring the Property Fund's continued financial stability. The larger the surplus, the greater the assurance that sufficient funds will be available to pay claims. The surplus may also help to keep premium rates stable and to ensure that reinsurance is available and affordable. However, too large a surplus balance may indicate the premium rates are too high, and the Property Fund must balance its need for an adequate surplus with local governments' needs for reasonable premium rates, especially as their financial resources are shrinking.

In 2004, OCI established $20.0 million as the target amount for a minimum surplus.

In 2004, the Property Fund established targets of a minimum surplus of $20.0 million, and a premium-to-surplus ratio of 1-to-1, (that is, for every $1 of total premiums received the Property Fund should have $1 in surplus). The 1-to-1 premium-to-surplus ratio has been a longtime insurance industry standard and is considered relatively conservative. The minimum surplus of $20.0 million reflects reinsurance coverage for individual losses exceeding $2.0 million, and is based on Wisconsin Administrative Code, which requires that no single risk assumed by an insurance company exceed 10 percent of surplus.

The surplus has consistently exceeded OCI's targets.

The June 30, 2008 surplus balance was more than one-and-one-half times OCI's target amount. Further, as shown in Table 3, the premium-to-surplus ratio has exceeded the 1-to-1 target in each of the past four years.

Table 3

Premium-to-Surplus Ratios
As of June 30

Year	Total Premiums[1]	Surplus Balance	Premium-to-Surplus Ratio
2005	$25,465,193	$34,517,526	1-to-1.4
2006	24,959,726	38,743,775	1-to-1.6
2007	21,781,426	40,920,793	1-to-1.9
2008	21,594,902	36,661,193	1-to-1.7

[1] Does not reflect premiums paid to the Property Fund's reinsurers, which are netted against premiums as reflected in the financial statements.

Management indicated that the Property Fund has a number of unique characteristics that warrant a larger surplus balance. For example, the Property Fund is more susceptible to risks that cannot be offset by diversification, because it cannot offer other types of insurance or offer insurance outside of Wisconsin. Further, the Property Fund cannot refuse to insure riskier entities the way a private insurer might. Management also indicated that larger surpluses may help to smooth premium rate changes over time, which can simplify local government's budgeting for property insurance each year.

OCI insurance examiners who monitor the financial solvency of domestic and foreign insurance companies confirmed that the Property Fund's unique characteristics may require a more conservative target than the existing 1-to-1 premium-to-surplus ratio.

In April 2009, OCI approved a more conservative target for the premium-to-surplus ratio.

During its semiannual meetings in 2007 and 2008, the Advisory Committee and the Oversight Committee discussed a more conservative target ratio of $1 in total premiums for every $2 of surplus. The Advisory Committee formally established this target surplus ratio at its April 9, 2009 meeting, and the Oversight Committee approved the change on April 29, 2009.

However, in calculating a premium-to-surplus ratio, an industry practice is to reflect premiums net of any premiums paid to reinsurers. Using this methodology, the Property Fund's premium-to-surplus ratio was $1 of premiums to $2.20 of surplus as of June 30, 2007, which is more conservative than a target of $1 of premiums to $2 of surplus.

Determining the optimal surplus balance is difficult. The Property Fund's actuary determined that while net premiums collected exceeded claims paid by a substantial margin for FY 2003-04 and FY 2004-05, claims exceeded net premiums for FY 2006-07 and FY 2007-08. If this trend continues, the surplus balance will be reduced in the future. We also note that, effective July 1, 2008, the Property Fund implemented a rate change that includes an estimated 9.7 percent reduction in rates for its largest insurance line, Buildings and Contents, which may also have the effect of reducing the surplus balance. On the other hand, OCI's unaudited statutory-based financial statements for the period ending March 31, 2009, reported a surplus balance of $40.0 million, $3.3 million higher than June 30, 2008.

OCI reports a surplus balance of $40.0 million at March 31, 2009.

Considering all these factors, it is important that OCI management and the Advisory Committee and the Oversight Committee continue to monitor the surplus balance to ensure it remains appropriate, especially given the fiscal constraints facing participating local governments.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance, working with its Advisory Committee, Oversight Committee, and actuary, continue to evaluate the Local Government Property Insurance Fund's existing target premium-to-surplus ratio for appropriateness.

Budgetary Accounting Concerns

The Legislature provides two appropriations to administer the Property Fund.

Wisconsin Statutes provide two appropriations in a segregated fund for administration of the Property Fund, both of which are funded from premiums and investment income. Section 20.145(3)(u), Wis. Stats., is the administration appropriation, an annual appropriation that allows the Legislature to exercise oversight and control of the Property Fund's administrative expenditures. Section 20.145(3)(v), Wis. Stats., is used to account for expenses other than administration, as specified in statutes. This continuing appropriation, which is referred to by management as the "operations appropriation," is specifically authorized for payments of losses and loss adjustment expenses, payments to the State of Wisconsin Investment Board for investment fees, fire rating bureau dues, the cost to purchase reinsurance, and payments to the General Fund.

During our audit, we became concerned with how OCI charged its appropriations for costs related to the purchase of a new computer system to administer the Property Fund. The system, which was implemented in 2004, is used to establish and collect premiums and to track and administer the payment of policyholder claims. In addition, a Web interface was created to allow policyholders to view their policy information, including the valuation of their insured property.

The Property Fund charged administrative costs related to a new computer system to two appropriations.

While costs related to a computer system are typically considered administrative in nature, OCI staff believe that some of the costs of the computer system would appropriately be accounted for as loss adjustment expenses that could be charged to the operations appropriation. However, OCI appears to have charged costs based on available funding, rather than on a consistent methodology for apportioning costs between the two appropriations. As shown in Table 4, system support fees were charged to the operations appropriation from FY 2003-04 to FY 2006-07, and then to the administration appropriation in FY 2007-08. Software customization costs were charged to both appropriations, but not allocated in any consistent manner.

Table 4

Property Fund System Related Payments
FY 2003-04 through FY 2007-08

	Administration Appropriation	Operations Appropriation
System Support Fee		
FY 2003-04		$ 18,000
FY 2004-05		60,000
FY 2005-06		72,000
FY 2006-07		100,000
FY 2007-08	$120,000	
Subtotal	120,000	250,000
Software Customization		
FY 2004-05		76,775
FY 2005-06	46,233	30,638
FY 2006-07	24,415	16,435
Subtotal	70,648	123,848
Total	**$190,648**	**$373,848**

OCI management believes that because the new system processes claims, which are paid from the operations appropriation, it was appropriate to charge a portion of its costs to the operations appropriation. However, OCI could not provide documentation to support that all of the costs charged to the operations appropriation were related to claims-processing capabilities, and we believe the absence of a documented methodology for charging costs between appropriations allows OCI to circumvent its budgetary authority and charge costs solely based on where budget authority remains available. At the end of FY 2004-05, OCI had fully expended its administration appropriation. Therefore, OCI charged 100.0 percent of the system support fees and customization costs for FY 2004-05 to the operations appropriation, rather than seeking increased expenditure authority from the Legislature for its administration appropriation.

Some other costs may have been inappropriately charged to the operations appropriation.

In addition, we question the appropriateness of some other costs OCI charges to its operations appropriation. For example, since at least 1997, OCI has charged the operations appropriation for payments for appraisal services, which are used to establish premium rates. Based on the statutory language for the operations appropriation, costs used to set premium rates would more appropriately be charged to the administration appropriation.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance:

- *develop and document a methodology for charging costs to its administration and operations appropriations; and*
- *seek appropriate authorization from the Legislature if large, one-time purchases are made, to ensure appropriate allocation of costs.*

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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, 2008, 2007, 2006, and 2005, as listed in the table of contents. These financial statements are the responsibility of 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, 2008, 2007, 2006, and 2005, 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 (GASB) Statement Number 40, *Deposit and Investment Risk Disclosures—an Amendment of GASB Statement No. 3*, for the fiscal years ended June 30, 2008, 2007, 2006, and 2005.

The Ten-Year Claims Development Information included on pages 45 through 47 is not a required part of the financial statements of the Wisconsin Local Government Property Insurance Fund referred to in the first paragraph, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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 13 through 23 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 19, 2009, on our consideration of the Wisconsin Local Government Property Insurance 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 considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

Carolyn Stittleburg

May 19, 2009 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 an 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, 2008, 2007, 2006, and 2005. 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 OCI. 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 have agents, does not advertise, and is not permitted to selectively underwrite risks. Otherwise, it operates like an insurance company by collecting premiums from its policyholders 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 seven subcommittees that include both members of the Advisory Committee and other policyholders. The current subcommittees are Mission Statement, Bylaws, Policy and Underwriting Issues, Rate Analysis, Loss Control and Claims, Information Technology, 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 excess-of-loss coverage, analogous to "reinsurance," through a broker.

Policy Count and Insurance in Force

The Property Fund has provided a stable property insurance outlet for Wisconsin local governments dating back to the early 1900s. Table A shows the Property Fund's policy counts and insurance in force each year since 2004.

Table A

Key Financial Statistics
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Policies	1,124	1,147	1,156	1,160	1,203
Insurance in Force	$45.5 billion	$42.8 billion	$39.9 billion	$37.2 billion	$35.9 billion

As of June 30, 2008, 1,124 policyholders were insured: 62 counties, 319 school districts, 158 cities, 191 towns, 274 villages, and 120 miscellaneous local government tax-supported entities (such as libraries or water, sanitation or fire department districts), down from a total of 1,203 policyholders in FY 2004. Of the reduction of 79 insureds from June 30, 2004, to June 30, 2008, 33 were townships, for which policy values and premiums are relatively small.

Total insurance in force as of June 30, 2008, was $45.5 billion, which is $9.6 billion higher than the $35.9 billion in force as of June 30, 2004. On average, the Property Fund's total insurance in force has increased by more than $2.4 billion each year since June 30, 2004. That growth is primarily due to inflationary increases in the insurance property base and to new construction.

Financial Statements

The Property Fund's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by GASB. The financial statements are prepared based on the economic resources measurement focus and the full accrual basis of accounting, and they consist of the following:

- the Statement of Net Assets, which reports on all assets and liabilities of the Property Fund;

- the Statement of Revenues, Expenses, and Changes in Fund Net Assets, which presents all revenues earned and expenses incurred during the year, as well as changes in fund net assets; and

- the Statement of Cash Flows, which presents information related to cash inflows and outflows summarized by operating, noncapital financing, and investing activities.

The notes to the financial statements provide additional detail to accompany the information in the financial statements.

Financial Position

Assets

The Property Fund's assets consist primarily of:

- cash and cash equivalents that are required to be invested in the State of Wisconsin Investment Fund, which is a short-term pool of state and local funds; and

- investments (for FYs 2004-05 and 2005-06 only) consist of high-grade fixed-income securities.

Both are managed by the State of Wisconsin Investment Board in accordance with state statutes. 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, with high priority given to matching the maturity of assets with the liquidity needs of the Property Fund's liabilities. In March 2006, it was determined that Wisconsin Statutes actually permitted the Property Fund to invest only in the State Investment Fund. Broader guidelines had been in place, which permitted investment in high-grade fixed-income securities. After that determination, no new investments were made outside of the State Investment Fund, and the Investment Board deposited the proceeds from the few remaining securities into the State Investment Fund upon maturity. In April 2008, Wisconsin Statutes were changed to allow for investments outside of the State Investment Fund, although no such investments were made through June 30, 2008.

Other assets include excess-of-loss insurance recoverable on paid claims, premiums receivable from policyholders, and accrued investment income.

Table B shows total assets over the four-year period from June 30, 2004, through June 30, 2008. Total assets increased by $19.8 million, or 54.4 percent, over the four years. Assets increased as a result of premium rate increases that first took effect in January 2003, coupled with favorable loss experience in FYs 2004-05, 2005-06, and 2006-07 and increases in investment income as discussed further in the revenue section.

Table B

Assets
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Total Assets	$56,154,412	$56,047,437	$53,868,937	$45,886,973	$36,371,361
Change from Prior Year	0.2%	4.0%	17.4%	26.2%	25.9%

Liabilities

Total liabilities have increased by 64.2 percent between June 30, 2004, and June 30, 2008. As an insurance entity, the Property Fund's primary liabilities are unpaid loss liabilities and deferred revenue for unearned premiums, which are recorded net of corresponding excess-of-loss coverage. Table C shows total liabilities over the four-year period from June 30, 2004, though June 30, 2008.

Table C

Liabilities
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Net Unpaid Loss Liabilities	$13,029,503	$ 9,531,540	$ 8,707,478	$ 3,812,360	$ 4,354,492
Deferred Revenue for Unearned Premiums	5,245,798	5,095,212	5,798,195	6,834,382	6,702,224
Other Current and Long-Term Liabilities	1,217,918	499,892	619,489	722,705	813,506
Total Liabilities	**$19,493,219**	**$15,126,644**	**$15,125,162**	**$11,369,447**	**$11,870,222**
Change Total Liabilities from Prior Year	28.9%	0.0%	33.0%	(4.2%)	(12.9%)

The loss liabilities include amounts for individual case estimates for reported losses, as well as estimates for losses that were incurred but not reported. Loss liabilities also include a provision for the estimated future payment of losses and loss expenses associated with the outstanding claims from insured localities.

The unpaid loss liabilities are the amounts expected to be paid in the future for incidents that have already occurred. The unpaid loss liabilities can fluctuate based on whether there are significant loss claims, such as those for major fires or windstorms, open at the end of the fiscal year. For example, the following large events occurred near the end of the fiscal years, and a portion of the loss was established as a liability as of June 30:

- a major explosion on December 6, 2006, damaged Property Fund–insured property in the amount of $3.1 million;
- a hail storm on April 13, 2006, resulted in damages of $2.9 million;
- a hail storm on June 6, 2007, accounted for an $8.4 million loss; and
- significant rains on June 8, 2008, resulted in covered water losses of $2.6 million.

Further, the severity of losses, on average, has increased during the four-year period, due in part to higher property values.

The change in deferred revenue for unearned premiums fluctuates with changes in premiums written and unearned excess-of-loss premium ceded.

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 its revenues and expenses, that is, its net income. The Property Fund's surplus increased from $24.5 million on June 30, 2004, to $36.7 million on June 30, 2008, as a result of favorable loss experience in comparison to premium revenues. Over the same time period, insurance risk in force increased from $35.9 billion to $45.5 billion. Table D summarizes changes in the Property Fund's surplus over the four-year period from June 30, 2004, through June 30, 2008.

Table D

Net Assets (Surplus)
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Fund Net Assets	$36,661,193	$40,920,793	$38,743,775	$34,517,526	$24,501,139
Change from Prior Year	(10.4%)	5.6%	12.2%	40.9%	60.5%

Property Fund management considers several factors in establishing an appropriate surplus level to maintain. First, in accordance with s. Ins 6.72(1), Wis. Adm. Code, minimum surplus is established using the criteria that "no single risk assumed by any insurance company (net of excess-of-loss insurance) shall exceed 10 percent of surplus as regards policyholders." In the Property Fund's case, its net retention is $2 million per occurrence, which yields a minimum surplus level of $20 million. Second, the Property Fund seeks to maintain its surplus at a level consistent with the insurance exposures in force and annual premiums written. As insurance in force has increased by $9.6 billion over the past four years, management has sought to maintain a higher surplus level. Finally, management also takes into consideration the fact that the Property Fund is a mono-line property insurer and operates solely in Wisconsin. These are elements that can cause increased volatility in annual loss experience, because the Property Fund does not have other lines of business or geographical regions to smooth out losses in a given year. The Property Fund also strives to smooth any rate changes over time, and thereby avoid large fluctuations in premiums charged to local units of government. After three successive years of increase, policyholder surplus declined by approximately $4.3 million in FY 2007-08. For further discussion of surplus, see the section labeled "Change in Fund Net Assets (Surplus)."

Change in Financial Position

Revenues

The Property Fund's operating revenues consist of premiums from insured local governments, net of excess-of-loss insurance premiums ceded. All Property Fund policyholders are billed annually, but not all are billed in the same renewal month because insurance policies are issued or renewed throughout the entire year. The Building and Contents line of insurance for the Property Fund's primary policy types uses rates obtained annually for each insured from an independent insurance rating organization. Other lines of insurance use rates established by the Oversight Committee, after considering input from an independent actuary and the Advisory Committee. Continuing a policy started in FY 2003-04, the Property Fund calculates each policyholder's premium based on 100 percent of insured value (formerly at 90 percent of value) and current (one year in arrears) policyholder-specific Insurance Services Office (ISO) loss costs.

The Property Fund had not implemented any significant changes in rates or coverages from July 1, 1996 through June 30, 2001. Since that time, several rate changes have occurred:

- On July 1, 2001, the Property Fund implemented a rate increase of 24.0 percent for the Building and Contents line.
- On July 1, 2002, the Property Fund implemented a 24.0 percent rate increase across all lines of business.
- On January 1, 2003, the Property Fund changed the Building and Contents loss multiplier from 0.74 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 ISO loss costs. The impact of these three actions was an average overall increase of 90 percent in Building and Contents rates.
- On July 1, 2005, the Property Fund implemented several reductions in rates, including a 13.2 percent reduction in the Monies and Securities rates, a 7.6 percent reduction in Automobile Physical Damage rates, a 12.9 percent reduction in certain Inland Marine rates, and a 50.0 percent reduction in Building and Contents rates for first-year new business and 35.0 percent for all other entities.
- On December 1, 2005, the Property Fund reduced Building and Contents rates by an average of 16.0 percent by adopting updated ISO loss costs.
- On July 1, 2006, the Property Fund again adopted revised ISO loss costs, and also revised Building and Contents deductible credits. The estimated overall impact of these changes was a decrease in premium rates of 14.5 percent.

As shown in Table E, operating revenues decreased over the four-year period ended June 30, 2008. The decline is attributable to ISO rate decreases, policyholders taking higher deductibles, and a small reduction in the number of policyholders (as was shown in Table A).

Table E

Operating Revenues
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Operating Revenues	$16,856,149	$17,825,997	$20,994,035	$20,958,820	$20,944,567
Change from Prior Year	(5.4%)	(15.1%)	0.2%	0.1%	65.7%

The Property Fund's nonoperating revenues consist of investment income earned from interest on shares in the State of Wisconsin Investment Fund and, for FY 2003-04 through FY 2005-06, interest or market gains on investments in high-grade fixed-income securities. As can be seen in Table F, there has been significant variability in investment income earnings each year.

Table F

Investment Income
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Investment Income	$2,333,556	$2,950,185	$2,058,842	$826,058	$255,907
Change from Prior Year	(20.9%)	43.3%	149.2%	222.8%	(72.2%)

Investment income fluctuates based on market conditions and the amount of funds available for investment. Total cash and cash equivalents and investments have increased by $21.1 million since June 30, 2004, and the higher balances provided for increased returns. For FY's 2006-07 and 2007-08, all of the Property Fund's investments were in the State's short-term cash investment account. The balance of cash and cash equivalents decreased in FY 2007-08, and that, combined with a decline in the State Investment Fund's rate of return during FY 2007-08, resulted in decreased investment income for that year compared to FY 2006-07.

Expenses

The Property Fund has two main categories of operating expenses: loss and loss expenses, and "other" operating expenses consisting of contracted services, personnel, and other expenses not related to losses or loss expenses. The Property Fund's largest operating expenses consist of loss and loss expenses paid, plus changes to the loss liabilities. Table G shows operating expenses and the ratios of those expenses to operating revenues for the past five years.

Table G

Operating Expenses
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Operating Expenses					
Net Losses and Loss Expenses	$21,937,927	$17,219,300	$17,393,352	$10,022,547	$10,523,346
Other Operating Expenses	1,509,247	1,378,138	1,431,417	1,744,121	1,440,710
Total Operating Expenses	**$23,447,174**	**$18,597,438**	**$18,824,769**	**$11,766,668**	**$11,964,056**
Ratios of Operating Expenses to Total Operating Revenues					
Net Losses and Loss Expenses	130.1%	96.6%	82.9%	47.8%	50.2%
Other Operating Expenses	9.0	7.7	6.8	8.3	6.9
Total Operating Expenses	**139.1%**	**104.3%**	**89.7%**	**56.1%**	**57.1%**

Loss expenses can vary widely depending both on claims paid and on claims reported during any given year. Further, loss expenses are affected by the changes to loss liabilities, which can be either positive or negative depending on changes in the reserves and estimated losses incurred but not reported. Any excess-of-loss insurance recoveries are netted in loss expense (see the "Excess-of-loss Program" section for more information). In a Property Fund analysis of five years of loss experiences, the major conclusion was that weather-related claims accounted for a significant portion of total losses.

Other operating expenses remained relatively stable.

Excess-of-loss Program

To transfer insurance risk, the Property Fund purchases excess-of-loss coverage in the commercial market. Note 5 of the Property Fund's notes to the financial statements contains a table showing terms of the excess-of-loss policies in effect during FY 2004-05 through FY 2007-08. On the Statement of Revenues, Expenses, and Changes in Fund Net Assets, premiums paid to excess-of-loss insurers are reported as a reduction of premium revenue, and claims paid by excess-of-loss insurers are reported as a reduction to losses and loss expenses paid by the Property Fund.

Table H compares the excess-of-loss insurance loss recoveries to excess-of-loss insurance premiums paid over the past five years.

Table H

Excess-of-loss Insurance Loss Recoveries versus Premiums

Fiscal Year Ended June 30	Recoveries Received from Excess-of-loss Insurers	Excess-of-loss Insurance Premiums Paid	Inflow from (Outflow to) Reinsurers
2004	$ 86,557	$5,710,491	$(5,623,934)
2005	234,826	4,506,373	(4,271,547)
2006	1,009,381	3,965,691	(2,956,310)
2007	6,113,716	3,955,429	2,158,287
2008	2,020,927	4,738,753	(2,717,826)

While the Property Fund paid more in premiums than it received in recoveries from excess-of-loss insurers each of these years, with the exception of FY 2006-07, the Property Fund uses excess-of-loss insurance to help reduce its exposure to significant loss events, given its levels of insurance in force as noted in Table A.

The Property Fund annually reviews with its excess-of-loss broker the per risk and aggregate excess-of-loss insurance retentions in relation to excess-of-loss insurance market pricing and selects a balance between risk retention and excess-of-loss insurance cost. As noted in the discussion of loss liabilities, the Property Fund had four major losses (two hail, one explosion, and one water) for which the excess-of-loss insurers reimbursed or will reimburse it in excess of its $2 million per occurrence.

Change in Fund Net Assets (Surplus)

The change in fund net assets (surplus) reflects all revenues (operating and nonoperating), less expenses and transfers. Table I shows the increases or decreases in net assets for each of the past five years.

Table I

Change in Net Assets
Fiscal Year Ended June 30

	2008	2007	2006	2005	2004
Increases (Decrease) in Net Assets	($4,259,600)	$2,177,018	$4,226,249	$10,016,387	$9,236,418

The change in net assets for FYs 2004-05, 2005-06 and 2006-07 resulted from the fact that premium and investment income were greater than loss and loss expenses incurred in each of those years. For the FY 2007-08 net loss, the opposite was true. These changes also illustrate the effects of the rating changes previously discussed. Those rating changes were made to initially build net assets and monitor them annually thereafter to find a target equilibrium point at which total revenues equal total expenses.

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.

Factors Affecting Future Periods

On July 1, 2008, the Fund adopted the most recent ISO loss costs and also modified the credit for the $1,000 Building and Contents deductible. The estimated rate level effect of these changes on Building and Contents rates was a decrease of 9.7 percent.

Contact Information

This financial report is designed to provide a general overview of the Local Government Property Insurance Fund's financial performance for FY 2004-05 through FY 2007-08. Questions concerning any of the information provided in this report, or requests for additional information, should be addressed to:

Dan Bubolz, Insurance Program Manager
Office of the Commissioner of Insurance
125 South Webster Street
Madison, Wisconsin 53703-3474

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Financial Statements ■

Statement of Net Assets
June 30, 2008, 2007, 2006, and 2005

	June 30, 2008	June 30, 2007	June 30, 2006	June 30, 2005
ASSETS				
Current Assets:				
Cash and cash equivalents (Notes 2 and 3)	$ 53,279,876	$ 54,734,976	$ 49,133,447	$ 36,365,855
Investments (Notes 2 and 3)	0	0	3,964,260	3,031,420
Receivables:				
Due from policyholders	323,731	970,700	746,380	1,463,620
Investment income receivable	0	0	24,850	83,318
Excess of loss insurance recoverable on paid claims (Notes 2 and 5)	2,550,805	341,761	0	973,566
Total Receivables	2,874,536	1,312,461	771,230	2,520,504
Total Current Assets	56,154,412	56,047,437	53,868,937	41,917,779
Noncurrent Assets:				
Investments (Notes 2 and 3)	0	0	0	3,969,194
TOTAL ASSETS	$ 56,154,412	$ 56,047,437	$ 53,868,937	$ 45,886,973
LIABILITIES AND NET ASSETS				
Current Liabilities:				
Unpaid loss liabilities (Notes 2, 4, and 5)	$ 13,029,503	$ 9,531,540	$ 8,707,478	$ 3,812,360
Deferred revenue for unearned premiums (Notes 2 and 5)	5,245,798	5,095,212	5,798,195	6,834,382
Premiums received in advance (Note 2)	235,122	0	0	0
Excess of loss insurance payable	532,070	247,314	183,415	128,576
Contracted and other services payable	408,250	230,484	412,296	577,060
Compensated absences	6,701	5,873	5,534	5,693
Due to State of Wisconsin	15,178	2,305	6,387	2,100
Total Current Liabilities	19,472,622	15,112,728	15,113,305	11,360,171
Noncurrent liabilities:				
Compensated absences	17,988	13,916	11,857	9,276
Other postemployment benefits	2,609	0	0	0
Total Noncurrent Liabilities	20,597	13,916	11,857	9,276
Total Liabilities	19,493,219	15,126,644	15,125,162	11,369,447
Net Assets:				
Restricted for fund purposes	36,661,193	40,920,793	38,743,775	34,517,526
TOTAL LIABILITIES AND NET ASSETS	$ 56,154,412	$ 56,047,437	$ 53,868,937	$ 45,886,973

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets for the Years Ended June 30, 2008, 2007, 2006, and 2005

	Year Ended June 30, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006	Year Ended June 30, 2005
OPERATING REVENUES				
Net Premiums Earned (Notes 2 and 5)	$ 16,856,149	$ 17,825,997	$ 20,994,035	$ 20,958,820
Total Operating Revenues	**16,856,149**	**17,825,997**	**20,994,035**	**20,958,820**
OPERATING EXPENSES				
Losses and Loss Expenses (Notes 2 and 5)	21,937,927	17,219,300	17,393,352	10,022,547
Contracted Services	1,352,280	1,221,344	1,238,730	1,411,074
Personnel Services	124,845	113,769	102,629	82,407
Other Expenses	32,122	43,025	90,058	250,640
Total Operating Expenses	**23,447,174**	**18,597,438**	**18,824,769**	**11,766,668**
OPERATING INCOME (LOSS)	**(6,591,025)**	**(771,441)**	**2,169,266**	**9,192,152**
NONOPERATING REVENUES (EXPENSES)				
Investment Income	2,333,556	2,950,185	2,058,842	826,058
Total Nonoperating Revenues	**2,333,556**	**2,950,185**	**2,058,842**	**826,058**
Income (Loss) Before Transfers	(4,257,469)	2,178,744	4,228,108	10,018,210
Transfers	(2,131)	(1,726)	(1,859)	(1,823)
CHANGE IN NET ASSETS	**(4,259,600)**	**2,177,018**	**4,226,249**	**10,016,387**
NET ASSETS				
Net Assets—Beginning of the Year	40,920,793	38,743,775	34,517,526	24,501,139
Net Assets—End of the Year	$ 36,661,193	$ 40,920,793	$ 38,743,775	$ 34,517,526

The accompanying notes are an integral part of this statement.

Statement of Cash Flows
for the Years Ended June 30, 2008, 2007, 2006, and 2005

	Year Ended June 30, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash Received for Premiums	$ 18,173,582	$ 16,962,593	$ 20,729,927	$ 20,620,850
Losses and Loss Expenses Paid	(20,649,008)	(16,736,999)	(11,524,668)	(8,635,824)
Cash Payments for Contracted Services	(1,151,080)	(1,405,012)	(1,410,306)	(1,437,822)
Cash Payments to Employee for Services	(124,845)	(113,769)	(102,629)	(82,407)
Other Operating Revenues (Expenses)	(35,174)	(42,853)	(76,537)	(245,511)
Net Cash Provided (Used) by Operating Activities	**(3,786,525)**	**(1,336,040)**	**7,615,787**	**10,219,286**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Transfers out	(2,131)	(1,726)	(1,859)	(1,823)
Net Cash Used by Noncapital Financing Activities	**(2,131)**	**(1,726)**	**(1,859)**	**(1,823)**
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from Sale and Maturities of Investments	0	4,000,000	3,000,000	4,830,000
Investment Income Received	2,333,556	2,939,295	2,153,664	1,190,705
Purchase of Investments	0	0	0	(3,985,326)
Net Cash Provided by Investing Activities	**2,333,556**	**6,939,295**	**5,153,664**	**2,035,379**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(1,455,100)**	**5,601,529**	**12,767,592**	**12,252,842**
Cash and Cash Equivalents at the Beginning of the Year	54,734,976	49,133,447	36,365,855	24,113,013
Cash and Cash Equivalents at the End of the Year	$ 53,279,876	$ 54,734,976	$ 49,133,447	$ 36,365,855

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, 2008	Year Ended June 30, 2007	Year Ended June 30, 2006	Year Ended June 30, 2005
Operating Income (Loss)	$ (6,591,025)	$ (771,441)	$ 2,169,266	$ 9,192,152
Adjustments to Reconcile Net Income to Net Cash and Cash Equivalents Provided by Operating Activities:				
Changes in assets and liabilities:				
Decrease (Increase) in due from policyholders	646,969	(224,320)	717,240	(400,946)
Decrease (Increase) in excess of loss insurance recoverable on paid claims	(2,209,044)	(341,761)	973,566	1,928,855
Increase (Decrease) in unpaid loss liabilities	3,497,963	824,062	4,895,118	(542,132)
Increase (Decrease) in deferred revenue for unearned premiums	150,586	(702,983)	(1,036,187)	132,158
Increase (Decrease) in premiums received in advance	235,122	0	0	0
Increase (Decrease) in excess of loss insurance payable	284,756	63,899	54,839	(69,182)
Increase (Decrease) in contracted and other services payable	177,766	(181,812)	(164,764)	(23,710)
Increase (Decrease) in compensated absences	4,900	2,398	2,422	2,293
Increase (Decrease) in due to State of Wisconsin	12,873	(4,082)	4,287	(202)
Increase (Decrease) in other postemployment benefits	2,609	0	0	0
Total Adjustments	2,804,500	(564,599)	5,446,521	1,027,134
Net Cash and Cash Equivalents Provided (Used) by Operating Activities	**$ (3,786,525)**	**$ (1,336,040)**	**$ 7,615,787**	**$ 10,219,286**
Noncash Investing, Capital, and Financing Activities:				
Net change in unrealized gains and losses	$ 0	$ 32,971	$ (52,604)	$ (255,321)

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 other enterprise fund in the State's basic financial statements. 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. It 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. 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 $500 to $100,000 per claim. Policyholders are obligated to pay the annual insurance premium and to report losses in a timely manner.

Policyholders are not subject to any premium assessments should a premium deficiency exist. Pursuant to s. 605.30, Wis. Stats., if the Fund did not have sufficient assets to pay claims that are due, the Department of Administration would transfer from the State's General Fund to the Property Fund amounts sufficient to pay the losses. The Property Fund would have to repay the General Fund. 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 or to require transfers from the General Fund.

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

Participation in the Property Fund, along with total insurance in force for FYs 2004-05 through 2007-08, can be seen in the table that follows.

	June 30, 2008	June 30, 2007	June 30, 2006	June 30, 2005
Counties	62	62	62	63
Cities	158	160	162	162
Towns	191	202	212	220
Villages	274	274	269	269
School Districts	319	326	326	326
Other	120	123	125	120
Total	1,124	1,147	1,156	1,160
Insurance in Force	$45.5 billion	$42.8 billion	$39.9 billion	$37.2 billion

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation and Financial Reporting Entity

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. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The accompanying financial statements were prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. With this measurement focus, all assets and liabilities associated with the operation of the Property Fund are included on the Statement of Net Assets. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when the related liabilities are incurred.

Revenues and expenses not related to the Property Fund's primary purpose are reported as nonoperating revenues and expenses. Currently, the Property Fund's only nonoperating activity consists of investment income and any related expenses offset within investment income.

The Property Fund applies all applicable GASB pronouncements. Financial Accounting Standards Board 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 expenses. In estimating these liabilities, management uses the methodology discussed in Note 2G.

D. Cash and Cash Equivalents

Cash and cash equivalents reported on the Statement of Net Assets and the Statement of Cash Flows are deposited with the State, where available balances beyond immediate needs are pooled 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. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

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*. Fair value information is determined using quoted market prices.

F. Premiums

Policies are generally written for annual terms. Premiums are recognized as revenue over the terms of the insurance policies by calculating the earned premium on each policy. The daily pro rata portion of premiums written that are applicable to the unexpired terms of insurance policies in force as of the date of the Statement of Net Assets are reported as deferred revenues for unearned premiums. Premiums received on policies that are not yet in force as of the date of the Statement of Net Assets are reported as a liability for premiums received in advance.

G. Unpaid Loss Liabilities

The Property Fund establishes unpaid loss liabilities based on estimates of the ultimate cost of insureds' losses and costs associated with settling losses that have been reported but not settled, and of losses and related loss expenses that have been incurred but not reported. The period of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts of excess-of-loss insurance recoverable on unpaid losses are deducted from unpaid loss liabilities, as discussed further in Notes 4 and 5. The unpaid loss liabilities account is not discounted to present value.

While management believes that unpaid loss liabilities 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 costs 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 losses and loss expenses resulting from the review process and from differences between estimates and payments for losses are charged or credited to expenses in the periods in which the estimates are charged or the payments are made.

H. Excess-of-loss Insurance Coverage

The Property Fund purchases excess-of-loss insurance coverage, the operation of which is analogous to "reinsurance," to reduce its exposure to large losses on all types of insured events. Earned premiums ceded to excess-of-loss insurers are netted within earned premiums on the Statement of Revenues, Expenses, and Changes in Fund Net Assets. The unearned portion of excess-of-loss insurance premiums paid is netted within the deferred revenue for unearned premiums liability on the Statement of Net Assets. Loss and loss expense recoveries from excess-of-loss insurance are netted within losses and loss expenses on the Statement of Revenues, Expenses, and Changes in Fund Net Assets. Excess-of-loss insurance recoverable on paid claims is included as an asset and excess-of-loss insurance recoverable on unpaid losses is netted within unpaid loss liabilities on the Statement of Net Assets. Further detail on excess-of-loss insurance coverage is disclosed in Note 5.

I. Policy Acquisition Costs

Since the Property Fund has no marketing staff, does no advertising, 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. Unused earned compensated absences, other than accumulated sick leave, are accrued with a resulting liability. The liability and the expenses for compensated absences are based on current rates of pay. The related employer's share of social security taxes, Medicare taxes, and contributions to the Wisconsin Retirement System is also accrued with a resulting liability. The compensated absences liability is classified as either a short-term or a long-term liability based upon an estimate determined by management.

K. Reclassifications

Certain amounts in the financial statements for June 30, 2005, and June 30, 2006, were reclassified to conform to the account titles for June 30, 2007, and June 30, 2008.

3. DEPOSITS AND INVESTMENTS

A. Deposits

The balance of cash and cash equivalents consists of cash deposited in the State's bank and cash invested by the State of Wisconsin Investment Board through the State Investment Fund. As of June 30, these balances at market value are as follows:

Cash and Cash Equivalents:	June 30, 2008	June 30, 2007	June 30, 2006	June 30, 2005
Deposits in the State's Bank	$ 75,245	$ 758	$ 995	$ 21,825
State Investment Fund Shares	53,204,631	54,734,218	49,132,452	36,344,030
Total Cash and Cash Equivalents	$53,279,876	$54,734,976	$49,133,447	$36,365,855

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), (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, certification of deposits issued by banks in the United States and solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

Custodial credit risk for deposits is the risk that, if a depository financial institution should fail, the Property Fund would not be able to recover deposits in the possession of an outside party. The Property Fund does not have a deposit policy specifically for custodial risk. Shares in the State Investment Fund are not required to be categorized under GASB Statement 40. For the remaining deposits in the State's bank, all deposits that are held in financial institutions are insured by the Federal Deposit Insurance Corporation for up to $100,000 ($250,000 from October 3, 2008, through December 31, 2009). The State of Wisconsin Public Deposit Guarantee fund insures up to $400,000 above the amount of federal insurance. Therefore, only the amount of the Property Fund's June 30 bank balance in excess of $500,000 would be exposed to custodial credit risk and considered uninsured and uncollateralized under GASB Statement 40. None of the Property Fund's June 30 balances were above $500,000, and therefore none would be considered uninsured and uncollateralized.

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.

The State of Wisconsin Investment Board recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation, and it monitors risk through multiple forms of analysis and reporting. Inspection of levels of diversification, nominal risk exposures, risk/return plots, and matching liabilities with assets forms the core of the monitoring process. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines, and any exceptions are remedied in a prudent manner. When identified, guideline exceptions are reviewed by the Investment Board's Compliance Committee, which currently meets on a quarterly basis.

In March 2006, the State of Wisconsin Investment Board identified a discrepancy with applicable Wisconsin Statutes that appeared to require the Property Fund to be invested solely in the State Investment Fund. (See Note 3A for the permitted investments for the State Investment Fund). The statutory requirement conflicted with broader guidelines the State of Wisconsin Investment Board had received from the Property Fund, which permitted the investment in high-grade fixed-income securities. Although other statutory language may have permitted those investments, the Office of the Commissioner of Insurance and the State of Wisconsin Investment Board decided that no new investments would be made outside of the State Investment Fund, and the Investment Board deposited the proceeds from the few remaining securities into the State Investment Fund upon maturity. In April 2008, Wisconsin Statutes were amended to explicitly allow for investments outside of the State Investment Fund as permitted by s. 25.17 (3)(a), Wis. Stats.

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Property Fund. The Property Fund's investment guidelines provide that issues be rated "A-" or better at the time of purchase, based on the minimum credit ratings issued by nationally recognized statistical rating organizations. As of June 30, these credit ratings were as follows:

	June 30, 2008		June 30, 2007	
Credit Rating	Fair Value	Percentage	Fair Value	Percentage
US Treasury	$ 0	0.0%	$ 0	0.0%
AAA	0	0.0	0	0.0
Subtotal	$ 0	0.0%	$ 0	0.0%
SIF[1]	53,099,000	100.0	54,495,000	100.0
Total	$53,099,000	100.0%	$54,495,000	100.0%

	June 30, 2006		June 30, 2005	
Credit Rating	Fair Value	Percentage	Fair Value	Percentage
US Treasury	$ 1,980,160	3.7%	$ 1,976,610	4.6%
AAA	1,984,100	3.8	5,024,004	11.6
Subtotal	$ 3,964,260	7.5%	$ 7,000,614	16.2%
SIF[1]	48,932,000	92.5	36,253,000	83.8
Total	$52,896,260	100.0%	$43,253,614	100.0%

[1] State Investment Fund shares are unrated and are reported on the Statement of Net Assets as Cash and Cash Equivalents.

Custodial Credit Risk—Custodial credit risk for investments is the risk that, if the counterparty to a transaction should fail, the Property Fund would not be able to recover the value of investments that are in possession of an outside party. The Property Fund does not have a policy specifically for custodial credit risk. As of June 30, 2005, June 30, 2006, June 30, 2007, and June 30, 2008, the Property Fund did not have any investment securities exposed to custodial credit risk.

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. The Property Fund's investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or sector exposure limits. General guidelines provide that no single issuer may exceed 5.0 percent of the total of Property Fund's investments plus cash and cash equivalents in the State Investment Fund, with the exception of the U.S. government and its agencies and the State Investment Fund, which may be unlimited. In addition, the Property Fund further limits AAA-rated mortgage-backed, AAA-rated asset-backed, and individual corporate issuers to 3.0 percent of the Property Fund's investments plus cash and cash equivalents in the State Investment Fund. None of the Property Fund's investments as of June 30, 2005, June 30, 2006, June 30, 2007, and June 30, 2008, exceeded these guidelines.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Property Fund uses the duration method to identify and manage its interest rate risk. The Property Fund's guidelines require that a bond's maturity must not exceed ten years.

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

	Government/Agency		State Investment Fund[1]		Total	
	Fair Value	Duration (in years)	Fair Value	Duration (in years)	Fair Value	Duration (in years)
June 30, 2008	$ 0	0.00	$53,099,000	0.14	$53,099,000	0.14
June 30, 2007	0	0.00	54,495,000	0.10	54,495,000	0.10
June 30, 2006	3,964,260	0.42	48,932,000	0.06	52,896,260	0.09
June 30, 2005	7,000,614	0.99	36,253,000	0.08	43,253,614	0.23

[1] State Investment Fund shares are reported on the Statement of Net Assets as Cash and Cash Equivalents.

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The Property Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2005, June 30, 2006, June 30, 2007, and June 30, 2008, the Property Fund did not own any issues denominated in a foreign currency.

4. UNPAID LOSS LIABILITIES

The Property Fund establishes a liability for both reported and unreported insured events that includes estimates of both future payments of losses and related loss 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)			
	2008	2007	2006	2005
Unpaid Loss Liabilities at Beginning of Year	$16,215	$9,619	$4,077	$ 8,006
Less: Excess-of-loss Insurance Recoverable	(6,684)	(912)	(265)	(3,652)
Net Unpaid Loss Liabilities at Beginning of Year	9,531	8,707	3,812	4,354
Incurred Losses and Loss Expenses:				
Provision for insured events of the current year	21,416	16,260	15,652	9,623
Increase (decrease) in provision for insured events of prior years	522	959	1,741	400
Total Incurred Losses and Loss Expenses	21,938	17,219	17,393	10,023
Payments[1]:				
Losses and loss expenses attributable to insured events of the current year	9,917	7,855	8,790	6,071
Losses and loss expenses attributable to insured events of prior years	8,522	8,540	3,708	4,494
Total Payments	18,439	16,395	12,498	10,565
Unpaid Loss Liabilities at End of Year	13,030	9,531	8,707	3,812
Plus: Excess-of-loss Insurance Recoverable	5,088	6,684	912	265
Total Unpaid Loss Liabilities at End of Year	$18,118	$16,215	$9,619	$4,077

[1] Payments include the change in excess-of-loss recoverable on paid losses and drafts outstanding of $2,209,044 in FY 2007-08; $341,761 in FY 2006-07; ($973,566) in FY 2005-06; and ($1,928,855) in FY 2004-05.

The unpaid loss liabilities are continually reviewed and adjusted as the claims develop and new information is received. These liabilities are necessarily based on estimates, and although management believes that the amounts are adequate, the ultimate liabilities will differ from the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are reviewed annually, and any adjustments are reflected in current earnings. The changes in the provision for incurred loss and loss expenses attributable to the prior fiscal years do not result in additional or return premiums for those years.

5. Excess-of-loss Insurance

To reduce its exposure to large losses on all types of insured events, the Property Fund purchases excess-of-loss insurance coverage, the operation of which is analogous to "reinsurance." Excess-of-loss insurance permits recovery of a portion of losses from the excess-of-loss insurers, 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 excess-of-loss insured risks as liabilities unless it is probable that those risks will not be covered by excess-of-loss insurers.

The following table shows the excess-of-loss insurance retentions, deductibles, and limits for the terms in force during the four years of these financial statements. For the aggregate excess-of-loss recoverable calculations, only individual loss amounts over the underlying per loss deductible are accumulated toward the aggregate retention, and once the aggregate retention is met, only individual loss amounts over $10,000 are included in the amount recoverable from the excess-of-loss insurers.

Excess-of-loss insurance Term	Per Risk Occurrence Retention	Aggregate Retention	Aggregate Limit	Aggregate Underlying per Loss Deductible
3/31/2004–3/31/2005	$2,000,000	$18,000,000	$325 million	$5,000
3/31/2005–3/31/2006	2,000,000	18,000,000	375 million	5,000
3/31/2006–3/31/2007	2,000,000	18,000,000	375 million	5,000
3/31/2007–3/31/2008	2,000,000	18,000,000	425 million	5,000
3/31/2008–3/31/2009	2,000,000	22,000,000	425 million	5,000

Premiums ceded to excess-of-loss insurers are netted within earned premiums on the Statement of Revenues, Expenses, and Changes in Fund Net Assets. The following table presents total premiums, excess-of-loss insurance premiums ceded, and net premiums earned.

	For the Year Ended June 30			
	2008	2007	2006	2005
Total Premiums	$21,594,902	$21,781,426	$24,959,726	$25,465,193
Less Excess-of-loss Insurance Premiums Ceded	4,738,753	3,955,429	3,965,691	4,506,373
Net Premiums Earned	$16,856,149	$17,825,997	$20,994,035	$20,958,820

Deferred revenue for unearned premiums is presented on the Statement of Net Assets net of related unearned excess-of-loss insurance premiums ceded. The following table presents total deferred premiums, unearned excess-of-loss insurance premiums ceded, and net deferred revenue for unearned premiums.

	For the Year Ended June 30			
	2008	2007	2006	2005
Total Deferred Premiums	$8,434,798	$8,321,209	$8,745,457	$9,740,202
Less Unearned Excess-of-loss Insurance Premiums Ceded	3,189,000	3,225,997	2,947,262	2,905,820
Net Deferred Revenue for Unearned Premiums	$5,245,798	$5,095,212	$5,798,195	$6,834,382

Loss and loss expense recoveries from the excess-of-loss insurers are netted within losses and loss expenses on the Statement of Revenues, Expenses, and Changes in Fund Net Assets. The following table presents total losses and loss expenses, losses recovered through excess-of-loss insurance, and net losses and loss expenses.

	For the Year Ended June 30			
	2008	2007	2006	2005
Total Losses and Loss Expenses	$23,958,202	$23,333,016	$18,402,733	$10,257,373
Less Losses Recovered through Excess-of-loss Insurance	2,020,275	6,113,716	1,009,381	234,826
Net Losses and Loss Expenses	$21,937,927	$17,219,300	$17,393,352	$10,022,547

Excess-of-loss insurance recoverable on unpaid losses decreases unpaid loss liabilities on the Statement of Net Assets. The following table presents total unpaid loss liabilities, estimated excess-of-loss insurance recoverable, and net unpaid loss liabilities.

	For the Year Ended June 30			
	2008	2007	2006	2005
Unpaid Loss Liabilities	$18,117,694	$16,215,495	$9,619,478	$4,077,545
Less Estimated Excess-of-loss Insurance Recoverable	5,088,191	6,683,955	912,000	265,185
Net Unpaid Loss Liabilities	$13,029,503	$ 9,531,540	$8,707,478	$3,812,360

6. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

As permanent full-time employees of the State, the Property Fund's employees are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee classification, plus employer contributions at a rate determined annually. Both employee and employer contributions are included as part of personnel expenses each year.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, effective for FY 2007-08. In accordance with the provisions of GASB Statement No. 45, the State is required to report other postemployment benefit (OPEB) expenses and related liabilities in the financial statements and notes. Since this statement was not adopted early, only the FY 2007-08 financial statements include the OPEB expenses as part of personnel expenses and the related liabilities. OPEBs include such items as the implicit subsidy of retiree health insurance present in the contribution rates for existing employees under the State's health insurance program, and the post-employment coverage in the State's life insurance program.

Copies of the separately issued financial reports for the Wisconsin Retirement System and the life insurance program are available on the Department of Employee Trust Funds' Web Site, *http://etf.wi.gov*. The disclosures for the health insurance plan are included in the State's Comprehensive Annual Financial Report, available on the Department of Administration's Web Site, *http://www.doa.state.wi.us*.

7. STATUTORY REPORTING

Similar to private insurance companies doing business in Wisconsin, the Property Fund files an annual financial statement with OCI. Such statements are prepared in conformity with statutory accounting practices prescribed or permitted by OCI. Statutory accounting practices differ from GAAP, which is the basis used to present financial statements included in this report, and follow a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations, and general administrative rules.

The differences between statutory and GAAP net assets and change in net assets 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, and an escheat liability being recorded under GAAP and not under statutory accounting.

	Net Assets		Change in Net Assets	
Fiscal Year	Statutory	GAAP	Statutory	GAAP
2008	$36,694,058	$36,661,193	$(4,262,652)	$(4,259,600)
2007	40,956,710	40,920,793	2,144,219	2,177,018
2006	38,812,491	38,743,775	4,292,374	4,226,249
2005	34,520,117	34,517,526	10,251,790	10,016,387

8. IMPLEMENTATION OF NEW ACCOUNTING STANDARDS

The Property Fund implemented GASB Statement Number 40, *Deposit and Investment Risk Disclosures—an Amendment of GASB Statement No. 3,* beginning in FY 2004-05. The primary changes under GASB Statement 40 were additional note disclosures required for the reporting of the Property Fund's deposits and investments.

The Property Fund implemented GASB Statement Number 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* beginning in FY 2007-08. The primary changes under GASB Statement 45 included displaying OPEB expenses and related liabilities in the financial statements and providing additional note disclosures.

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Required Supplementary Information ■

The table on page 47 illustrates how the Property Fund's total revenues (net of excess-of-loss insurance premiums ceded) compares to related costs of losses and loss expenses (net of losses assumed by excess-of-loss insurers) 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 excess-of-loss premium ceded, and net earned premium and investment revenues.

2. Loss Expenses—Shows each fiscal year's loss expenses paid (included in line 4), including defense and containment costs and other adjusting expenses.

3. Estimated Incurred Losses and Expenses as of End of Policy Year—Shows gross incurred losses and loss expenses (both paid and accrued), losses assumed by excess-of-loss insurers, and the net amount of incurred losses and loss 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 for losses and loss expenses as of the end of successive years for each policy year.

5. Reestimated Ceded Losses and Expenses—Shows the reestimated amount of losses and loss expenses assumed by excess-of-loss insurers as of the end of the current fiscal year for each policy year.

6. Reestimated Net Incurred Losses and Expenses—Shows the development of each policy year's incurred losses and loss expenses as of the end of successive years. The annual reestimated amounts result from new information received on known losses and from reevaluation of existing information on known losses, as well as from the emergence of new losses not previously known.

7. Increase/Decrease in Estimated Incurred Losses and Expenses from End of Policy Year—Compares the most recent reestimation for net incurred loss and loss expenses (line 6) 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 and loss expenses currently recognized in less mature policy years.

Ten-Year Claims Development Information

Fiscal Policy Year Ended June 30
(in thousands)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1. Premiums and Investment Revenue:										
Earned	$11,396	$11,801	$13,578	$14,518	$18,190	$26,920	$26,291	$27,018	$ 24,732	$23,929
Ceded	1,023	1,055	2,258	2,815	4,602	5,710	4,506	3,965	3,956	4,739
Net Earned	10,373	10,746	11,320	11,703	13,588	21,210	21,785	23,053	20,776	19,190
2. Loss Expenses	604	536	621	652	629	618	623	522	404	182
3. Estimated Incurred Losses and Expenses, as of End of Policy Year:										
Incurred	12,543	16,134	14,125	14,837	18,589	11,118	11,367	16,564	22,226	22,037
Ceded	4,127	7,881	1,075	979	4,183	0	1,744	912	5,966	621
Net Incurred	8,416	8,253	13,050	13,858	14,406	11,118	9,623	15,652	16,260	21,416
4. Net Paid (Cumulative) as of:										
End of policy year	4,206	4,866	5,060	7,278	9,040	7,138	6,074	8,790	7,855	9,917
One year later	7,452	7,344	12,333	13,669	12,431	10,841	9,313	16,498	16,387	
Two years later	7,714	8,088	13,459	14,814	13,002	11,105	9,983	16,286		
Three years later	7,714	7,741	13,437	14,923	13,004	11,105	9,983			
Four years later	7,714	7,760	13,437	14,981	13,004	11,105				
Five years later	7,714	7,760	13,437	14,981	13,004					
Six years later	7,714	7,760	13,437	14,981						
Seven years later	7,714	7,760	13,437							
Eight years later	7,714	7,760								
Nine years later	7,714									
5. Reestimated Ceded Losses and Expenses	3,544	5,922	2,939	352	3,647	0	1,806	1,869	7,491	621
6. Reestimated Net Incurred Losses and Expenses:										
End of policy year	8,416	8,253	13,050	13,858	14,406	11,118	9,623	15,652	16,260	21,416
One year later	7,785	7,692	12,773	14,014	12,722	11,024	10,087	16,629	16,923	
Two years later	7,714	8,135	13,459	14,898	13,007	11,977	10,978	16,286		
Three years later	7,714	7,741	13,492	14,995	13,004	11,105	10,978			
Four years later	7,714	7,760	13,437	15,484	13,004	11,105				
Five years later	7,714	7,760	13,437	14,981	13,004					
Six years later	7,714	7,760	13,437	14,981						
Seven years later	7,714	7,760	13,437							
Eight years later	7,714	7,760								
Nine years later	7,714									
7. Increase/Decrease in Estimated Incurred Losses and Expenses from End of Policy Year	$ (702)	$ (493)	$ 387	$ 1,123	$ (1,402)	$ (13)	$ 1,355	$ 634	$ 663	N/A

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, 2008, 2007, 2006, and 2005, and have issued our report thereon dated May 19, 2009. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the Wisconsin Local Government Property Insurance Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Wisconsin Local Government Property Insurance Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Wisconsin Local Government Property Insurance Funds' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We identified a deficiency that we consider to be a significant deficiency in internal control over financial reporting.

We found the Office of the Commissioner of Insurance's process for preparing, reviewing, and approving the financial statements of the Local Government Property Insurance Fund did not prevent or detect misstatements in the financial statements. The following errors were noted during the audit and subsequently corrected by management:

- Investments were misclassified between current assets and noncurrent assets, resulting in offsetting errors of $4.0 million in FY 2005-06 and $3.0 million in FY 2004-05, on the Statement of Net Assets. In addition, investment disclosures required under GASB 40 were not complete.

- Premiums received in advance of $0.2 million were inappropriately classified as contracts and other services payable on the Statement of Net Assets.

- Excess-of-loss insurance payable was not separately identified as a significant payable balance on the face of the financial statements or in the notes to the financial statements.

In addition, the Wisconsin Local Government Property Insurance Fund did not appropriately calculate the amount recoverable for FY 2007-08 from its excess-of-loss insurers. This error was identified by the excess-of-loss insurers and communicated to the Office of the Commissioner of Insurance in January 2009. The Office of the Commissioner of Insurance informed the auditors of this issue and made an adjustment to the financial statements in April 2009. The error resulted in a $0.9 million understatement of net losses and loss expenses, a $0.2 million understatement of unpaid loss liabilities, and a $0.7 million overstatement of excess-of-loss insurance recoverable on paid claims on the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

Management corrected the errors noted and indicated that it will be adding additional review procedures in an attempt to detect significant errors before the financial statements are issued. In addition, management is making changes to its excess-of-loss insurance calculation and review process to ensure errors are prevented or detected in the future.

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

The Wisconsin Local Government Property Insurance Fund's written response to findings identified is described above. We did not audit the Property Fund's response and, accordingly, express no opinion on it.

We noted certain matters that we reported to the management of the Wisconsin Local Government Property Insurance Fund in a separate letter dated April 29, 2009.

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 is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Wisconsin Local Government Property Insurance Fund's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

Carolyn Stittleburg

May 19, 2009 by

Carolyn Stittleburg
Audit Director

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Sean Dilweg, Commissioner

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May 22, 2009

Janice Mueller, State Auditor
Legislative Audit Bureau
22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703

Dear Ms. Mueller:

Thank you for providing a copy of the LAB draft audit report and the proposed draft management letter for the Local Government Property Insurance Fund to OCI for review and comment. Overall, I am quite pleased with the results of the LAB audit and appreciate the courtesy displayed by your staff throughout this process. The value of an audit report extends beyond obtaining an unqualified opinion on the Fund's financial position and includes receiving audit recommendations for OCI to implement to improve Fund operations. We intend to fully comply with both recommendations, as noted below:

Recommendation No. 1:

We recommend the Office of the Commissioner of Insurance, working with its Advisory Committee and Oversight Committee and actuary, continue to evaluate the Local Government Property Insurance Fund's existing target premium-to-surplus ratio for appropriateness.

OCI Response: OCI will continue to evaluate the premium to surplus ratio for appropriateness, on an annual basis, and will solicit input from the Fund's Advisory and Oversight Committees, and its actuary, during those deliberations.

The audit report narrative summarizes a number of issues relating to the importance of maintaining an adequate surplus position, so we will not repeat those in this reply. Commentary on factors considered in establishing an appropriate surplus level is also contained in the Fund's Management Discussion and Analysis section labeled "Net Assets (Surplus)".

The draft audit report noted that on April 9, 2009, the Fund's Advisory Committee formally established an even more conservative target premium-to-surplus ratio: $1 in total premium for every $2 of surplus. Actually, at its October 24, 2007 meeting and again at its April 9, 2008 meeting, the topic of the goal for premium to surplus was discussed by the Advisory Committee including discussion of the ratio of $.50 of premium to $1 of surplus. Both times, following discussion, the Advisory Committee adopted the financial report as presented. Therefore the action taken at its April 9, 2009 meeting was not to set a more conservative target premium-to-surplus ratio but rather to explicitly endorse the target premium-to-surplus ratio that had been implicitly in use for the past three years.

Recommendation No 2.

We recommend the Office of the Commissioner of Insurance:

- *Develop and document a methodology for charging costs to its administration and operations appropriations; and*
- *Seek appropriate authorization from the Legislature if large, one-time purchases are made, to ensure appropriate allocation of costs.*

Response: The Fund acknowledges the concerns currently being raised by the Legislative Audit Bureau with respect to coding of administrative expenses. Although this coding issue never surfaced in prior LAB audits of the Fund, now that it has been identified as needing clarification, the Fund will review how all expenses are being coded and implement a plan to:

1. Develop and document an appropriate methodology for charging costs to its administrative and operations appropriations,
2. Monitor to ensure that costs are being charged to the appropriations in accordance with the approved methodology, and
3. In the future, the Fund will seek appropriate authorization from the Legislature to make large, one-time purchases, to ensure appropriate allocation of costs.

I would like to specifically note that the audit is not raising any questions about the justification for payment of expenses, but rather how certain expenses are being coded to different appropriations.

I would also note that any changes to how operational or administrative expenses are to be coded will result in a zero ($0) sum change. That is, in total, no additional dollars have been nor will be spent from the fund's overall segregated balance based on how expenses are coded. The funds that were spent were used to develop and enhance the basic computer system used to administer many Fund functions and processes. And as a web application, the system is used by the insureds themselves for a variety of risk management and other local governmental purposes, as well as by our claims administrator and other parties.

With regards to the coding of the Fund's computer system, some system expenses were coded to the administrative and some to the operational appropriations, if these appeared to relate to the loss adjustment process. However, the Fund agrees that coding was not always consistently applied during the audit period. Whether a system feature, function or enhancement ought to be systematically coded to the administrative appropriation, regardless of whether or not it relates to the loss adjustment process, will be specifically addressed when developing the appropriate methodology for overall expense coding, as noted above.

Finally, we appreciate the LAB noting that while it found a handful of misstatements in the four years of financial statements covered by the audit, the errors were not considered to be a material weakness. OCI will use the audit findings to identify and secure additional resources to ensure more systematic reviews of our financial reporting.

In closing and on behalf of OCI and the Fund, I extend our collective thanks to the Legislative Audit Bureau staff for the care and professionalism they exhibited while conducting this segregated fund audit. Thank you again for the opportunity to respond to the comments in your draft report.

Please contact me if you have any questions on the above responses.

Sincerely,

Sean Dilweg
Commissioner of Insurance

SD:dcb

cc: John Montgomery, Insurance Administrator
Dan Bubolz, Insurance Program Manager