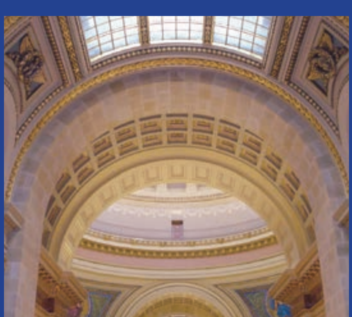
Report 13-4
March 2013

Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

State of Wisconsin



Legislative Audit Bureau

Report 13-4
March 2013

Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

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From the Office of the Commissioner of Insurance

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Joe Chrisman
State Auditor

March 8, 2013

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

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94(1)(de), Wis. Stats., we have completed a financial audit of the Injured Patients and Families Compensation Fund, which insures health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. The Fund is managed by a Board of Governors and administered by the Office of the Commissioner of Insurance (OCI). We have provided an unqualified auditor's report on the Fund's financial statements as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010.

The Fund's financial position improved significantly over the last three years, in part, because of the repayment of funds after the July 2010 Wisconsin Supreme Court ruling that a $200 million transfer required by 2007 Wisconsin Act 20 was unconstitutional. Improvements in the investment market also provided additional investment income, and the Fund reported a net asset balance of $361.3 million as of June 30, 2012. Because of the significant increase in the Fund's net assets, we recommend that OCI work with the Board of Governors to establish formal parameters for annually evaluating the appropriateness of the Fund's net asset balance.

Because OCI has not established adequate procedures and controls to ensure the accuracy of its financial statements, we again identified financial statement errors and also report a material weakness in the Fund's internal controls over financial reporting. We recommend that OCI establish and document clear procedures for completing and verifying the accuracy of the Fund's financial statements.

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

Respectfully submitted,

Joe Chrisman
State Auditor

JC/DA/ss

Report Highlights ▪

The Fund provides secondary medical malpractice insurance to approximately 14,000 health care providers.

The Fund has experienced significant fluctuations in annual total claims payments.

The Fund's financial position has improved significantly.

A target range for net asset balances and a process to evaluate them should be established.

OCI needs to improve the Fund's financial reporting process.

The Injured Patients and Families Compensation Fund provides participating physicians and other health care providers in Wisconsin with secondary medical malpractice insurance to cover claims that exceed the coverage limits of their primary insurance. Statutes require most health care providers that operate or have permanent practices in Wisconsin to maintain primary malpractice coverage of $1.0 million for each incident and $3.0 million per policy year, and to participate in the Fund by paying assessments that help to fund claims greater than these amounts.

There is no limit to the compensation the Fund will pay on behalf of participating providers for economic damages, such as medical costs and loss of income. Noneconomic damages, which include compensation for suffering, mental distress, and loss of companionship and affections, are currently limited by statutes to $750,000.

The Fund is governed by a 13-member Board of Governors. The Office of the Commissioner of Insurance (OCI) has statutory responsibility for administering the Fund.

Statutes require the Legislative Audit Bureau to perform a financial audit of the Fund at least once every three years. In completing our audit, we reviewed the Fund's internal controls; assessed the fair presentation of its financial statements; and evaluated compliance with certain statutory provisions. We also reviewed the financial status of the Fund and followed up on prior audit recommendations. Our audit report contains our unqualified opinion on the Fund's financial statements and related notes as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010.

Annual Assessment Rates

Assessment rates have regularly increased over the last four years, with average annual increases ranging from 5.0 percent to 9.9 percent. Physicians are assessed rates for fiscal year (FY) 2012-13 coverage that range from $1,534 for general practice physicians to $10,125 for obstetric and neurological surgeons.

Claim Payments

The Fund has paid $807.8 million for 660 claims from its inception in 1975 through June 30, 2012. Thirty-six of the claims have been for amounts of $5.0 million or more and represent 41.7 percent of the total claim payments. The largest claim was $34.3 million paid in FY 2007-08 for an incident that occurred in FY 2003-04.

A small number of large-value claims can significantly affect the Fund's operations and cash flow. For example, annual total claim payments of $50.3 million in FY 2007-08 and $65.7 million in FY 2008-09 represent the two largest years of payments since the Fund's inception. In contrast, annual total claim payments in FY 2011-12 were negative because unused funds in two future medical expense accounts totaling $1.9 million reverted back to the Fund upon the death of two claimants.

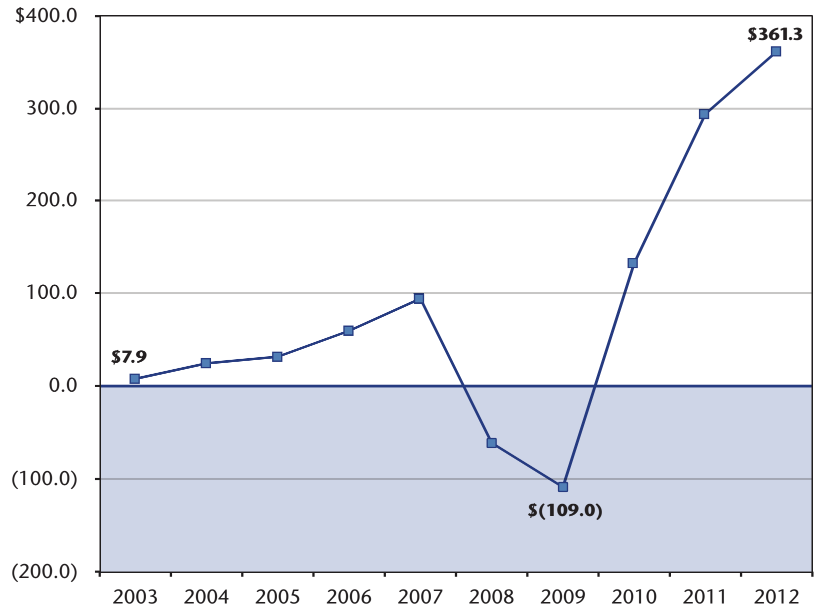
Financial Position

The Fund's financial position is represented by its net asset balance, which is the difference between its assets and its liabilities. As shown in Figure 1, the Fund's net asset balance was $361.3 million as of June 30, 2012.

The Fund's loss liabilities are based on estimates of what it may be required to pay for malpractice incidents that have occurred but may not yet have been settled or even reported. The Board of Governors relies on a consulting actuarial firm to estimate the Fund's liabilities.

Figure 1

Net Asset Balance[1]
As of June 30
(in millions)



[1] Represents the Fund's assets less its liabilities.

Estimating the Fund's loss liabilities is challenging because of the long-term nature, infrequency, and severity of claims covered by the Fund as a secondary medical malpractice insurer and the absence of a limit on the amount of economic damages that the Fund may be required to pay. Legislation and court decisions have also contributed to the uncertainty in estimating the Fund's loss liabilities. Estimates of the Fund's loss liabilities have been regularly reduced over the last several years as claims experience has been more favorable than expected.

The Fund's financial position also has been significantly affected over the last five years by a $200 million transfer from the Fund to the State's Medical Assistance Trust Fund required by 2007 Wisconsin Act 20. Largely due to the $200 million transfer, the Fund's net asset balance declined 215.5 percent from $94.4 million as of June 30, 2007, to -$109.0 million as of June 30, 2009.

The Fund's net asset balance increased significantly in FY 2009-10 in anticipation of the return of the funds as the result of a July 2010 Wisconsin Supreme Court ruling that the transfer was unconstitutional. The Dane County Circuit Court subsequently issued an order in July 2011 that required the State to also pay the Fund $33.7 million for the Fund's estimated lost investment earnings, interest expense paid by the Fund, and attorney fees to be paid to the Wisconsin Medical Society. In August 2011, the State transferred $233.7 million to the Fund from the General Fund.

The Fund's financial position also has been affected by the economy and investment markets over the last five years. At least part of the decline in the Fund's net asset balance in FY 2008-09 was the result of negative investment earnings associated with the recession that began in 2008. As the investment markets have improved in recent years, the Fund has experienced increases in its investment earnings, which totaled $54.1 million in FY 2010-11 and $67.5 million in FY 2011-12.

Due to the significant increase in the Fund's net asset balance in recent years, it will be important for the Board of Governors to establish formal parameters for assessing the overall sufficiency or reasonableness of the Fund's net asset balance. Such parameters will help the Board make future decisions about the Fund's financial operations and communicate information about the Fund's financial position.

Actuarial Audits

In response to our prior audit recommendations, the Fund now contracts for actuarial audits every three years to evaluate the reasonableness of the actuarial methodology and assumptions used in developing estimates of the Fund's loss liabilities. All three actuarial audits completed to date have concluded that the Fund's loss liabilities were reasonable, although conservative. The most recent actuarial audit, which was completed in December 2011, concluded that the Fund's 5.5 percent investment rate assumption was aggressive. In December 2011, the Board of Governors approved a reduction in the investment rate assumption to 5.0 percent and, in September 2012, approved a further reduction to 4.5 percent.

Need for Improvements in Financial Reporting

Accurate financial reporting is important to help ensure that interested parties have confidence in the Fund's financial operations and the Board of Governors has the best information available to make key decisions regarding the Fund's future financial operations. However, OCI has not established adequate procedures and controls to ensure the accuracy of the Fund's financial statements. As a result, we again identified financial statement errors as part of our audit and we report a material weakness in the Fund's internal controls over financial reporting.

Recommendations

We include recommendations for the Office of the Commissioner of Insurance to:

☑ work with the Board of Governors to establish a target range of minimum and maximum net asset balances for the Fund and to establish a process to evaluate the appropriateness of the targets on an annual basis *(p. 19)*; and

☑ reassess the Fund's current financial reporting process and take steps to establish and document clear procedures for completing and verifying the accuracy of the Fund's financial statements, including:

- comparing actual results of the Fund's financial activities to expectations;
- reconciling and verifying key account balances to supporting or corroborating sources of information;
- reviewing the continued accuracy of formulas and links in spreadsheets; and
- establishing checklists to document that critical steps are completed *(p. 22)*.

▪▪▪▪

Introduction ■

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

The Injured Patients and Families Compensation Fund insures health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. It was created as the Patients Compensation Fund in Chapter 37, Laws of 1975, in response to concerns over the cost and availability of medical malpractice insurance. 2003 Wisconsin Act 111 changed the Fund's name to the Injured Patients and Families Compensation Fund and established it as an irrevocable trust for the sole benefit of health care providers participating in the Fund and proper claimants.

The Commissioner of Insurance chairs the 13-member Board of Governors that manages the Fund. OCI has statutory responsibility for administering the Fund, although it contracts for claims administration, actuarial, and risk management services. Through FY 2010-11, OCI contracted with Liberty Mutual Group for claims administration services. In FY 2011-12, a new company, Wausau MedMal Management Services, LLC, began providing claims administration services and was paid $971,577 in that year. Pinnacle Actuarial Resources, Inc., provides actuarial services and was paid $23,284 in FY 2011-12, and Marsh USA, Inc., provides risk management services and was paid $57,389 in FY 2011-12.

The Fund's investments are managed by the State of Wisconsin Investment Board. Its cash balances are deposited into the State Investment Fund, which is a short-term pool of state and local funds managed by the Investment Board.

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

Statutes require most health care providers that operate or have permanent practices in Wisconsin to:

- maintain primary malpractice coverage of $1.0 million for each incident and $3.0 million per policy year; and
- participate in the Fund, which provides unlimited liability coverage for economic damages that exceed the primary limits established in statutes.

The Fund insures individual health care providers, such as physicians and nurse anesthetists; institutions such as hospitals, ambulatory surgery centers, and certain nursing homes; entities that are owned or controlled by hospitals; and entities such as medical partnerships, corporations, and cooperatives. As of June 30, 2012, 84.9 percent of the 13,975 health care providers participating in the Fund were physicians.

Assessment rates vary by provider type.

Participating providers pay annual assessments based on their type and specialty. For example, among individual providers, assessment rates are higher for physicians than for nurses, and higher for physicians who perform surgery than for those who do not. The Appendix lists annual assessment rates for various providers from FY 2005-06 through FY 2012-13. Assessment rates have regularly increased over the last four years, as shown in Table 1.

Table 1

Annual Percentage Changes to Provider Assessment Rates

Policy Year	Average Percentage Change Approved by Board	Assessment Revenues
FY 2008-09	0.0%	$26,184,712
FY 2009-10	9.9	29,627,550
FY 2010-11	8.6	33,191,145
FY 2011-12	8.5	36,371,756
FY 2012-13	5.0	38,800,000[1]

[1] Estimated

The Fund has paid $807.8 million for 660 claims from its inception through June 30, 2012.

The Fund has paid $807.8 million for 660 claims from its inception in 1975 through June 30, 2012. Individual claim payments have ranged from $4,000 to $34.3 million. As shown in Table 2, 72.1 percent of paid claims have been for amounts less than $1.0 million. However, these 476 claims account for only 20.2 percent of the Fund's total claim payments through June 30, 2012. In contrast, 36 claims with payments of $5.0 million or more represent 41.7 percent of the total claim payments over that time period.

Table 2

Paid Claims from the Fund's Inception through June 30, 2012

Claim Amount	Number of Paid Claims	Percentage of Paid Claims	Amount Paid for All Claims	Percentage of Total Payments for All Claims
$5.0 Million or More	36	5.5%	$336,699,618	41.7%
At Least $1.0 Million but Less Than $5.0 Million	148	22.4	308,162,168	38.1
Less Than $1.0 Million	476	72.1	162,919,226	20.2
Total	**660**	**100.0%**	**$807,781,012**	**100.0%**

As shown in Table 3, the Fund has made claim payments of $10 million or more for nine claims through June 30, 2012. The largest claim was $34.3 million paid in FY 2007-08 for an incident that occurred in FY 2003-04.

Table 3

Claim Payments of $10 Million or More through June 30, 2012

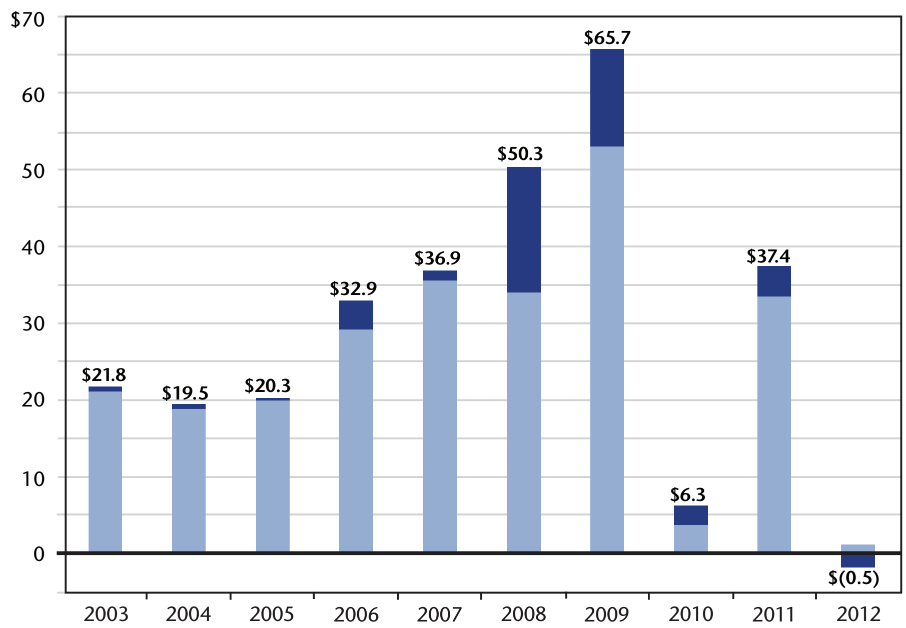
Amount (in millions)[1]	Fiscal Year of Incident	Fiscal Year of Payment	Claimant Allegations
$34.3	2004	2008	Negligent blood transfusion caused cardiac arrest and brain damage.
22.0	2005	2011	Negligent labor and delivery caused brain damage.
18.0	1986	1993	Diet pills prescribed without a complete physical evaluation caused cardiac arrest and brain damage.
16.3	2007	2009	Improperly performed surgical procedure caused brain damage.
15.6	1994	1997	Negligent treatment caused quadriplegia.
13.6	1994	2001	Initial surgery and follow-up treatment of pinched nerve were negligent, which caused continuing pain.
11.0	2004	2007	Negligent delivery caused brain damage.
10.1	1997	2006	Negligent treatment caused brain damage.
10.0	2002	2007	Negligent labor and delivery caused brain damage.

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

A small number of large-value claims can significantly affect the Fund's operations and cash flow. The uncertainty and long-term nature of medical malpractice claims makes it difficult to predict if or when large claims will be settled and paid from the Fund. As a result, annual total claim payments can fluctuate from year to year, as shown in Figure 2. The annual total claim payments include both payments made directly to the claimant at the time of the settlement or judgment, which are shown as claims payments, and amounts placed into accounts to pay medical expenses as they are incurred in the future, which are shown as net future medical. The Fund is required by s. 655.015, Wis. Stats., to establish accounts for settlements or judgments that provide for future medical expenses in excess of $100,000. Any account balance remaining when a claimant dies reverts back to the Fund.

Figure 2

Annual Total Claim Payments[1]
For Fiscal Year Ended June 30
(in millions)



Claim Payments—includes those payments made directly to the claimant at the time of the award.

Net Future Medical—includes amounts placed into accounts to pay for future medical expenses of the claimant as they are incurred less reversions of unused balances back to the Fund upon death of the claimant.

[1] Total claim payments are negative in FY 2011-12 because unused funds in two future medical expense accounts totaling $1.9 million reverted back to the Fund upon the death of two claimants.

A 2005 Supreme Court ruling on the constitutionality of noneconomic damages affected claims payments for several years.

The FY 2007-08 claim payments of $50.3 million and the FY 2008-09 claim payments of $65.7 million represent the two largest years of claim payments since the Fund's inception. The steady increase in total claim payments from FY 2005-06 through FY 2008-09 was, in part, attributable to a 2005 Wisconsin Supreme Court ruling that found a $350,000 inflation-adjusted limit on noneconomic damages in medical malpractice cases unconstitutional because it violated equal protection guarantees in the Wisconsin Constitution. A new limit of $750,000 on noneconomic damages was enacted by the Legislature on April 6, 2006. However, because of the Court's 2005 decision, there were no limits on the recovery of noneconomic damages for incidents that occurred on or prior to April 5, 2006. As a result, several claims paid during FY 2005-06 through FY 2008-09 included noneconomic damage awards that were significantly larger than either the old or the current limit. The largest noneconomic damages award was $11.5 million, which was included as part of the $34.3 million claim paid in FY 2007-08.

After the four-year period of steady increases, annual total claim payments have fluctuated significantly over the last three years. Annual total claim payments decreased to $6.3 million in FY 2009-10 and increased to $37.4 million in FY 2010-11. In FY 2011-12, annual total claim payments were negative because unused funds in two future medical expense accounts totaling $1.9 million reverted back to the Fund upon the death of two claimants.

By law, the Legislative Audit Bureau is responsible for performing financial audits of the Injured Patients and Families Compensation Fund. In completing our audit, we reviewed the Fund's internal controls; assessed the fair presentation of its financial statements as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010; and reviewed compliance with certain statutory provisions. We also reviewed the financial status of the Fund and followed up on prior audit recommendations.

■ ■ ■ ■

Financial Operations of the Fund ▪

Although their interests and priorities differ, health care providers, users of health care services, and attorneys in malpractice cases all benefit by having confidence in the reliability and soundness of the Fund's financial operations. Several factors have had a significant effect on the Fund's financial operations in recent years, including legislative action, court decisions, changes in its actuarial analyses, and the financial markets. Concerns with the Fund's financial reporting process can affect confidence in the Fund's financial operations.

Financial Status of the Fund

The Fund accumulated $1.0 billion in cash and investments as of June 30, 2012.

Since its creation in 1975, the Fund has regularly received more provider assessments and investment income than it has paid out in claims and administrative expenses. As a result, as of June 30, 2012, the Fund accumulated $1.0 billion in cash and investments, which is managed by the State of Wisconsin Investment Board. Income earned on the Fund's investments helps to reduce the provider assessments needed to pay current and future claims.

The Fund estimates it has $665.8 million in loss liabilities as of June 30, 2012.

The Fund's financial position is also significantly affected by its loss liabilities, which are based on estimates of what it may be required to pay for malpractice incidents that have occurred but may not yet have been settled or even reported. The Board of Governors relies on the Fund's consulting actuarial firm, Pinnacle Actuarial Resources, Inc., to help estimate loss liabilities. The Fund reported estimated loss liabilities totaling $665.8 million as of June 30, 2012.

The Fund currently has a positive financial position with a net asset balance of $361.3 million as of June 30, 2012.

The Fund's financial position is represented by its net asset balance, which is the difference between its assets and liabilities. As shown in Table 4, the Fund currently has a positive financial position with a net asset balance of $361.3 million as of June 30, 2012.

Table 4

Net Asset Balance[1]
As of June 30
(in millions)

Year	Amount
2003	$ 7.9
2004	24.6
2005	31.7
2006	59.8
2007	94.4
2008	(61.5)
2009	(109.0)
2010	132.8
2011	293.8
2012	361.3

[1] Represents the Fund's assets less its liabilities.

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

As noted, loss liabilities significantly affect the Fund's financial position. However, accurately estimating the Fund's loss liabilities is challenging because:

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

The consulting actuaries have regularly reduced past estimates of loss liabilities because of more favorable claims experience than expected.

As a result, the Fund's consulting actuary reviews and revises individual and total loss liability estimates each year, based on subsequent experience and information. Over the past several years, the current and former consulting actuaries have regularly reduced past estimates of the Fund's loss liabilities because claims experience has been more favorable than originally expected. For example, in estimating liabilities as of June 30, 2012, the Fund's consulting actuary reduced previously reported liabilities for the years through FY 2010-11 by $93.0 million, based on the additional year of experience. These reductions have contributed to the Fund's positive financial results over the last three fiscal years.

The Fund's financial position also has been significantly affected over the last five years by a $200 million transfer from the Fund to the State's Medical Assistance Trust Fund required by 2007 Wisconsin Act 20, and the subsequent return of the funds from the State's General Fund following a July 2010 Wisconsin Supreme Court ruling that the transfer was unconstitutional. Table 5 provides a time line of the events pertaining to the initial $200 million transfer, Dane County Circuit Court and Wisconsin Supreme Court proceedings, and ultimate repayment of the funds.

The Fund's financial position improved significantly after the July 2010 Wisconsin Supreme Court's ruling that the $200 million transfer was unconstitutional.

Largely due to the $200 million transfer, the Fund's net asset balance declined 215.5 percent from $94.4 million as of June 30, 2007, to -$109.0 million as of June 30, 2009. In addition to the effect of the transfers, the Fund's financial position also was negatively affected by the loss of potential future earnings on the $200 million. The Fund's net asset balance increased significantly in FY 2009-10 in anticipation of the return of the funds as the result of the Wisconsin Supreme Court ruling. The Dane County Circuit Court subsequently issued an order in July 2011 that required the State to also pay the Fund $33.7 million for the Fund's estimated lost investment earnings, interest expense paid by the Fund, and attorney fees to be paid to the Wisconsin Medical Society. In August 2011, the State transferred $233.7 million to the Fund from the General Fund.

Table 5

Time Line for $200 Million Transfer

Date	Event
October 2007	2007 Wisconsin Act 20 required that $200 million be transferred from the Injured Patients and Families Compensation Fund to the Medical Assistance Trust Fund. $71.5 million was transferred. The Wisconsin Medical Society filed a lawsuit challenging the constitutionality of the transfer.
July 2008	The remaining $128.5 million was transferred.
December 2008	The Dane County Circuit Court dismissed the lawsuit.
March 2009	The Wisconsin Medical Society appealed the Circuit Court's decision.
July 2010	The Wisconsin Supreme Court ruled that the transfer represented an unconstitutional taking of private property without just compensation. It remanded the case back to the Circuit Court to issue an order on the repayment of the money transferred together with lost investment earnings and interest that had been charged to the Fund. The Wisconsin Supreme Court cited s. 655.27(6), Wis. Stats., which defines the Fund as an irrevocable trust, and it placed a permanent injunction prohibiting a transfer of money out of the Fund pursuant to 2007 Wisconsin Act 20.
July 2011	The Dane County Circuit Court signed an order directing the State to transfer a total of $233.7 million to the Fund on or before October 1, 2011. The $233.7 million included repayment of the $200 million transfer, $33.7 million for estimated lost investment earnings, interest charged to the Fund, and attorney fees to be paid to the Wisconsin Medical Society.
August 2011	The State transferred $233.7 million to the Fund from the General Fund. The Fund paid the Wisconsin Medical Society $691,106 in attorney fees.

The Fund's financial position has also been affected by the economy and investment markets over the last five years.

The Fund's financial position also has been affected by the economy and investment markets over the last five years. At least part of the decline in the Fund's net asset balance from -$61.5 million as of June 30, 2008, to -$109.0 million as of June 30, 2009, was due to the recession that began in 2008. The Fund reported negative investment earnings of -$3.5 million during FY 2008-09 because of realized losses from investments sold and unrealized losses for investments still held during the economic downturn. As the investment markets have improved in recent years, the Fund has experienced an increase in its investment earnings, which totaled $54.1 million in FY 2010-11 and $67.5 million in FY 2011-12.

In consultation with the Fund's consulting actuary, the Board of Governors attempts to match annual assessments with the ultimate claims that are associated with events that occurred during the period of insurance coverage, within various statutory limits for establishing annual assessment rates. In establishing assessment rates, the Board also considers the Fund's financial position, its cash flow needs, and Wisconsin's medical malpractice environment. The Board increased assessment rates by 8.6 percent for FY 2010-11, 8.5 percent for FY 2011-12, and 5.0 percent for FY 2012-13. In December 2012, the Board approved a 5.0 percent decrease in assessment rates for FY 2013-14.

The Board of Governors' focus in the past has been to ensure the Fund was accumulating sufficient assets to pay claims as they were due. However, because of the significant increase in the Fund's net asset balance in recent years, the focus now shifts to managing the surplus and determining an appropriate net asset balance to maintain in the Fund. In any insurance operations, a surplus balance of net assets is important for unexpected claims and investment activities. The uncertainties associated with the long-term nature of the Fund as a secondary medical malpractice insurer and the absence of a limit on the amount of economic damages that the Fund may be required to pay further increases the importance of maintaining a sufficient surplus balance.

Additional parameters are needed for assessing the overall sufficiency or reasonableness of the Fund's net asset balance.

However, the Board of Governors has not established formal parameters for assessing the overall sufficiency or reasonableness of the Fund's net asset balance. We believe that it will be important for OCI to work with the Board and the Fund's consulting actuary to establish such parameters, such as targeted minimum and maximum net asset balances to maintain, to help the Board make future decisions about the Fund's financial operations and communicate information to various interested parties about the Fund's financial position.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance work with the Board of Governors to establish a target range of minimum and maximum net asset balances for the Injured Patients and Families Compensation Fund to maintain and to establish a process to evaluate the appropriateness of the targets on an annual basis.

Actuarial Audits

Actuarial audits are completed every three years.

In response to prior audit recommendations, the Board of Governors established a policy that requires OCI to contract for an actuarial audit of the Fund every three years. As part of the actuarial audit, another actuary independent of the Fund's consulting actuary assesses the reasonableness of the actuarial methodology and assumptions used in developing estimates of the Fund's loss liabilities. Such reviews or audits are fairly common for critical actuarial analyses, such as those completed for the Fund.

To date, the Fund has contracted for three actuarial audits, with the most recent audit completed in December 2011. All three of the actuarial audits concluded that the Fund's loss liabilities were reasonable, although conservative. Each of the audits also recommended certain improvements to the process for estimating the Fund's loss liabilities. The Fund's consulting actuary has given careful consideration to these recommendations and, correspondingly, has made changes to its procedures to address the recommendations.

In report 07-3, we recommended that the next actuarial audit evaluate the appropriateness of the Fund's explicit loss liability risk margin, which represents the risk that actual losses could be higher than predicted, and the Fund's investment return assumption used to take into account estimated future investment returns that will be available to help pay future loss liabilities. This recommendation was not addressed as part of the September 2008 actuarial audit because of an oversight by the Fund's management. We made this recommendation again in report 10-4.

The December 2011 actuarial audit recommended that the Fund reduce its investment rate assumption.

The December 2011 actuarial report addressed the explicit risk margin and the investment return assumption, as we recommended. The actuarial auditor concluded that the Fund's selected 25 percent risk margin was reasonable based on the variability of the Fund's losses from year to year. However, the actuarial auditor indicated that the Fund's 5.5 percent investment rate assumption was aggressive, especially in anticipation that more than one-third of the Fund's fixed-income securities will mature by June 30, 2015, and likely will need to be reinvested in lower-yielding investments than the Fund currently owns. The actuarial auditor recommended that the Fund consider decreasing the investment rate assumption to a more conservative range of 4.5 to 5.0 percent.

Before the actuarial audit report was released, the Board of Governors' Finance, Investment and Audit Committee, which is tasked with monitoring the investment rate assumption, recommended that the Board decrease the investment rate assumption to 5.0 percent for estimating the Fund's loss liabilities as of June 30, 2012. The Board of Governors met in December 2011 and approved that recommendation. In September 2012, the Board approved a further reduction of the investment rate assumption to 4.5 percent, which will be used by the Fund's consulting actuary in future estimates.

Need for Improvements in Financial Reporting

We identified material errors in the Fund's financial statements.

Accurate financial reporting is important to help ensure that interested parties have confidence in the Fund's financial operations and the Board of Governors has the best information available to make appropriate decisions regarding the Fund's future financial operations. Therefore, it is important that effective procedures and controls are in place to prevent, or to detect and correct in a timely manner, financial statement errors. However, because OCI has not established adequate procedures and controls to ensure the accuracy of the Fund's financial statements, we identified material errors in the financial statements for FY 2010-11 and FY 2011-12. Specifically, we identified that:

- loss liabilities and underwriting expenses were overstated by $62.9 million in the Fund's FY 2010-11 draft financial statements;

- loss liabilities and underwriting expenses were understated by $79.1 million in the Fund's FY 2011-12 draft financial statements; and

- several amounts in the draft cash flow statements for both FY 2010-11 and FY 2011-12 were misstated, including corresponding loss liability amounts and amounts pertaining to investment activities.

Fund staff subsequently corrected the financial statements for these and other less significant errors we identified during our audit work.

In part, the errors in the FY 2010-11 and FY 2011-12 financial statements may have occurred and not been detected as a result of recent turnover in key Fund staff and management positions involved with the financial reporting process. However, more significantly, OCI has not devoted sufficient attention and effort to addressing concerns with the Fund's financial reporting process. In report 10-4, we identified errors in the Fund's FY 2006-07 and FY 2008-09 financial statements and reported a concern with the Fund's internal controls.

Although OCI responded in 2010 that it would implement improvements to its process, sufficient improvements were not made or maintained to prevent or detect material errors in its financial statements. Therefore, our concerns continue and we report a material weakness in the Fund's internal controls over financial reporting, as further discussed in the report section titled "Report on Internal Control and Compliance." This material weakness was also recently included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters related to our audit of the State of Wisconsin's financial statements that was issued on January 10, 2013.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance reassess the Injured Patients and Families Compensation Fund's current financial reporting process and take steps to establish and document clear procedures for completing and verifying the accuracy of the Fund's financial statements, including:

- *obtaining a full understanding of the Fund's financial activities, developing corresponding expectations for the Fund's financial accounts, comparing actual results to expectations, and following up on differences;*
- *reconciling and verifying key account balances to supporting or corroborating sources of information, such as reconciling investment balances and activities to information provided by the State of Wisconsin Investment Board;*
- *reviewing the continued accuracy of formulas and links in spreadsheets used in the preparation of financial statements; and*
- *establishing checklists to document that critical steps are completed in the preparation and review of the financial statements.*

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Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the Wisconsin Injured Patients and Families Compensation Fund

We have audited the accompanying financial statements of the Wisconsin Injured Patients and Families Compensation Fund as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the Wisconsin Injured Patients and Families Compensation Fund's management. 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 1, the financial statements referred to in the first paragraph present only the Wisconsin Injured Patients and Families Compensation Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin as of June 30, 2012, June 30, 2011, and June 30, 2010, and the changes in its financial position, and, where applicable, its cash flows for the years then ended 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 Injured Patients and Families Compensation Fund as of June 30, 2012, June 30, 2011, and June 30, 2010, 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 5, the Wisconsin Injured Patients and Families Compensation Fund's projected ultimate loss liabilities are estimates based on recommendations of a consulting actuary. The Wisconsin Injured Patients and Families Compensation Fund's Board of Governors and management believe that the estimated loss liabilities are reasonable and represent the most probable estimates of the losses the Fund will pay for the claims incurred as of the end of the fiscal years. However, uncertainties inherent in projecting the frequency and severity of large secondary medical malpractice insurance claims, the Fund's unlimited liability coverage, and extended reporting and settlement periods make it likely that amounts paid will ultimately differ from the reported estimated liabilities. These differences cannot currently be quantified.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 19, 2013, on our consideration of the Wisconsin Injured Patients and Families Compensation Fund's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Wisconsin Injured Patients and Families Compensation Fund. The supplementary information included as Management's Discussion and Analysis on pages 25 through 33 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures to the information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

LEGISLATIVE AUDIT BUREAU

February 19, 2013 by Diann Allsen

Diann Allsen
Audit Director

Management's Discussion and Analysis ■

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

This section presents Management's Discussion and Analysis of the financial performance of the Wisconsin Injured Patients and Families Compensation Fund during the fiscal years ended June 30, 2012, June 30, 2011, and June 30, 2010. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the management of the Fund.

Overview of the Fund

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

The Board is assisted by its Actuarial and Underwriting Committee; Legal Committee; Claims Committee; Finance, Investment, and Audit Committee; Risk Management and Patient Safety Committee; and Peer Review Council. The Board and its committees meet quarterly.

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

Financial Statements

The Fund's financial statements have been prepared in a format prescribed by the Board of Governors and in accordance with accounting principles generally accepted in the United States of America. Financial statements for each of the past three years follow this discussion and analysis.

Assets

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

The Fund's investment strategy is to invest at least 75.0 percent of its assets in fixed-income securities that have a reasonable degree of safety of principal, as well as income-paying ability. The rest may be invested in equities or as a cash reserve with a maximum of 20.0 percent being in equities. High priority is given to matching the maturity of assets with the liquidity needs of the liabilities. Equities made up 17.5 percent of total investments as of June 30, 2012, 18.1 percent as of June 30, 2011, and 17.2 percent as of June 30, 2010, so the Fund was in compliance with the investment guideline that limits equities to no more than 20.0 percent of total investments. Investments are reported at market value.

As shown in Table A, there have been increases in total assets over the last three years. The increase from June 30, 2009, to June 30, 2010, was primarily the result of establishing a $202.6 million receivable for the anticipated repayment of the transfer made to the Medical Assistance Trust Fund pursuant to 2007 Wisconsin Act 20. The Wisconsin Supreme Court ruled in July 2010 that the transfer was unconstitutional and that the State needed to repay the transfer. The receivable as of June 30, 2011, was increased by $31.1 million as the result of a July 2011 order by the Dane County Circuit Court that established the final settlement amount as $233.7 million. The increase in assets from June 30, 2011, to June 30, 2012, is largely attributed to investment gains as well as a significant decrease in the amount of claims paid.

Table A

Total Assets
As of June 30

Year	Total Assets	Percentage Change from Prior Year
2012	$1,028,483,286	10.1%
2011	934,533,411	9.3
2010	855,125,527	32.5
2009	645,148,643	–

Loss Liabilities

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

Table B

Total Loss Liabilities
As of June 30

Year	Total Loss Liabilities	Percentage Change from Prior Year
2012	$665,777,868	4.6%
2011	636,503,075	(11.7)
2010	721,071,213	6.8
2009	675,406,400	–

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

The loss liabilities can also be affected by the interest rate assumption and corresponding discount factor used in determining their present value, as required by s. Ins. 17.27(3), Wis. Adm. Code. Changes in the discount factor, as well as the amount of the estimated loss liabilities and available assets, affect the contra liability account—amount representing interest—and the change in that account, which is reflected as an underwriting expense. The Board of Governors decreased the investment assumption from 5.5 percent to 5.0 percent effective for the loss liabilities as of June 30, 2012, which has an effect of increasing the present value of the loss liabilities. The investment rate assumptions resulted in discount factors of 0.841 for FY 2011-12, 0.824 for FY 2010-11, 0.820 for FY 2009-10, and 0.812 for FY 2008-09.

Net Assets

The Fund's net assets, or the balance of assets in excess of liabilities, for the past four years are shown in Table C. The changes in net assets are largely attributable to the difference between revenues collected and expenses paid; changes made to loss liability estimates for previous years as determined by the actuary; and unrealized investment gains and losses, which reflect changes in the market value of held investments.

Table C

Net Assets
As of June 30

Year	Net Assets	Percentage Change from Prior Year
2012	$361,261,614	23.0%
2011	293,798,420	121.2
2010	132,802,845	221.9
2009	(108,982,094)	–

The significant increase in net assets from June 30, 2009, to June 30, 2010, was largely a result of recognizing the anticipated repayment of the $200.0 million transfer to the Medical Assistance Trust Fund and increased investment income. The increase in net assets from June 30, 2010, to June 30, 2011, was attributable to a reduction in loss liabilities and recognition of an additional $31.1 million receivable primarily for lost investment earnings the State owed to the Fund because of the $200 million transfer. The increase in net assets from June 30, 2011, to June 30, 2012, can be attributed to an increase in investment income, as well as a significant decrease in the dollar amount of claims paid.

Revenues

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

As shown in Table D, total revenues increased significantly from FY 2008-09 to FY 2009-10, primarily as a result of improvements in the investment markets and the elimination of the negative State Investment Fund balance. Investment income further increased in FY 2011-12 after the Fund received and invested the cash repayment from the General Fund of $233.7 million in August 2011.

Table D

Total Revenues

Fiscal Year	Total Revenues	Percentage Change from Prior Year
2011-12	$103,931,752	19.0%
2010-11	87,310,907	(10.6)
2009-10	97,648,280	328.0
2008-09	22,814,166	–

Assessment revenues, which are shown in Table E, depend on the number of each type of provider participating in the Fund and the assessment rates in effect for each provider type. The Board of Governors authorized changes in assessment rates as follows: no changes for FY 2008-09, a 9.9 percent increase for FY 2009-10, an 8.6 percent increase for FY 2010-11, and an 8.5 percent increase for FY 2011-12. Total assessments can fluctuate at a rate somewhat different than the approved rate change because of changes in the number and classification of providers.

Table E

Assessment Revenues

Fiscal Year	Assessment Revenues	Percentage Change from Prior Year
2011-12	$36,371,756	9.6%
2010-11	33,191,145	12.0
2009-10	29,627,550	13.1
2008-09	26,184,712	–

Physicians are classified into one of four classes based upon a risk assessment of their specialty. Hospitals are assessed based upon the number of beds and outpatient visits. As shown in Table F, as of June 30, 2012, the vast majority of Fund participants were physicians.

Table F

Providers by Type
As of June 30, 2012

Provider Type	Number of Providers	Percentage of Total Providers
Physicians	11,866	84.9%
Corporations	1,205	8.6
Nurse Anesthetists	655	4.7
Hospitals	126	0.9
Partnerships	27	0.2
Hospital-affiliated Nursing Homes	19	0.1
Hospital-owned or -controlled Entities	22	0.2
Ambulatory Surgery Centers	54	0.4
Cooperatives	1	0.0
Total	**13,975**	**100.0%**

Investment income, which includes bond interest, stock dividends, investment gains and losses, and interest expense, is shown in Table G. The Fund earned interest income ranging from $24.9 million to $32.7 million over the four-year period from its debt securities. Annual investment income can also be significantly affected by changes in unrealized gains and losses associated with changes in the market value of the Fund's investments, which can be affected by the Fund's experience in the equities market, changes in the ratings of some of the bonds in the Fund's debt portfolio, and changes in the interest rate environment. The Fund recognized unrealized investment gains of $37.6 million in FY 2011-12, $26.6 million in FY 2010-11, and $40.9 million in FY 2009-10. In contrast, the Fund recognized unrealized investment losses of $22.1 million and realized losses of $13.2 million from the sale of investments in FY 2008-09.

Table G

Investment Income[1]

Fiscal Year	Investment Income[1]	Percentage Change from Prior Year
2011-12	$67,517,498	24.9%
2010-11	54,074,633	(20.4)
2009-10	67,930,959	1,396.7
2008-09	(5,238,593)	–

[1] Includes interest expense payments for the temporary loan through the State Investment Fund.

In FY 2008-09, the Fund paid $1.7 million in interest on a negative balance in the State Investment Fund account. The Fund attained a positive State Investment Fund balance and paid only a negligible amount of interest in FY 2009-10.

Underwriting Expenses

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

Table H

Underwriting Expenses

Fiscal Year	Underwriting Expenses	Percentage Change from Prior Year
2011-12	$ 35,884,135	181.1%
2010-11	(44,272,481)	(176.7)
2009-10	57,691,740	194.4
2008-09	(61,115,954)	–

The major cause of the significant changes in the underwriting expenses is changes in actuarial projections related to the outstanding liabilities for unpaid losses and loss adjustment expenses. In addition, any changes to the interest rate used in the discounting of the loss liabilities, such as the decrease from 5.5 percent to 5.0 percent in FY 2011-12, will flow through to the underwriting expenses.

In FY 2008-09 and FY 2010-11, the Fund reported negative underwriting expenses in total, because decreases to total loss liability estimates were greater than increases. The Fund reduced its loss liability estimates from prior years based upon an actuarial analysis that concluded a previous level of conservatism in the estimates was no longer needed. The liability includes an explicit risk margin that is established to ensure that loss liabilities will remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments.

Summary

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

Investments are predominantly conservative (approximately 80.0 percent in investment-grade bonds and 20.0 percent in equities), with the intent to match assets with liabilities while maximizing return.

Contacting the Fund's Financial Management

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

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

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Financial Statements ■

Statement of Net Assets
June 30, 2012, 2011, and 2010

	June 30, 2012	June 30, 2011	June 30, 2010
ASSETS			
Current Assets:			
Cash and Cash Equivalents (Note 3)	$ 39,978,226	$ 9,729,636	$ 18,356,342
Investments (Note 3)	69,593,881	30,806,972	35,682,131
Investment Income Receivable	9,461,818	7,121,581	7,154,946
Advance to the Medical Assistance Trust Fund (Note 4)	0	233,747,081	0
Assessments Receivable	245,142	249,476	4,550
Other Assets	27,444	27,897	46,784
Total Current Assets	119,306,511	281,682,643	61,244,753
Noncurrent Assets:			
Investments (Note 3)	874,699,028	615,282,693	555,906,309
Advance to the Medical Assistance Trust Fund (Note 4)	0	0	202,587,765
Restricted Cash and Cash Equivalents (Note 3)	34,010,396	37,190,375	35,059,139
Capital Assets, Net of Accumulated Depreciation	467,351	377,700	327,561
Total Noncurrent Assets	909,176,775	652,850,768	793,880,774
TOTAL ASSETS	**1,028,483,286**	**934,533,411**	**855,125,527**
LIABILITIES			
Current Liabilities:			
Loss Liabilities—Current Portion (Note 5)	82,214,231	79,816,675	86,334,986
Assessments Received in Advance	208,982	2,463,069	718,971
Provider Refunds Payable	1,059,192	732,653	370,658
General and Administrative Expense Payable	72,608	915,656	81,329
Medical Mediation Panel Fees Payable (Note 6)	12,420	37,834	159
Total Current Liabilities	83,567,433	83,965,887	87,506,103
Noncurrent Liabilities:			
Loss Liabilities (Note 5):			
Loss Liability for Incurred but not Reported Losses	619,211,192	610,453,190	655,652,804
Loss Liability for Reported Losses	20,146,674	7,149,424	56,028,392
Loss Liability for Loss Adjustment Expense	112,230,853	109,580,633	124,918,894
Estimated Loss Liabilities	751,588,719	727,183,247	836,600,090
Amount Representing Interest	(119,821,247)	(127,870,547)	(150,588,016)
Discounted Loss Liabilities	631,767,472	599,312,700	686,012,074
Liabilities for Future Medical Expense	34,010,396	37,190,375	35,059,139
Total Loss Liabilities	665,777,868	636,503,075	721,071,213
Less: Loss Liabilities—Current Portion	(82,214,231)	(79,816,675)	(86,334,986)
Noncurrent Loss Liabilities	583,563,637	556,686,400	634,736,227
Compensated Absences and OPEB Liabilities	90,602	82,704	80,352
Total Noncurrent Liabilities	583,654,239	556,769,104	634,816,579
TOTAL LIABILITIES	**667,221,672**	**640,734,991**	**722,322,682**
NET ASSETS			
Net Assets (Note 2l):			
Invested in Capital Assets	467,351	377,700	327,561
Restricted for Injured Patients and Families	360,794,263	293,420,720	132,475,284
TOTAL NET ASSETS	**$ 361,261,614**	**$ 293,798,420**	**$ 132,802,845**

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, 2012, 2011, and 2010

	Year Ended June 30, 2012	Year Ended June 30, 2011	Year Ended June 30, 2010
OPERATING REVENUES			
Assessments	$ 36,371,756	$ 33,191,145	$ 29,627,550
Assessment Interest and Administrative Fee Income	35,644	35,883	86,041
Total Operating Revenues	**36,407,400**	**33,227,028**	**29,713,591**
OPERATING EXPENSES			
Underwriting Expenses:			
Net Losses Paid	1,211,182	33,587,316	3,879,618
Loss Adjustment Expenses Paid	3,867,772	4,874,519	4,585,068
Risk Management Expenses	57,390	46,280	90,072
Medical Expenses Paid	1,472,998	1,787,542	2,472,169
Change in Liability for Incurred but not Reported Losses	8,758,002	(45,199,614)	26,106,944
Change in Liability for Reported Losses	12,997,250	(48,878,968)	22,988,180
Change in Liability for Loss Adjustment Expense	2,650,220	(15,338,261)	22,266
Change in Amount Representing Interest	8,049,300	22,717,469	(2,541,268)
Change in Liability for Future Medical Expense	(3,179,979)	2,131,236	88,691
Total Underwriting Expenses	35,884,135	(44,272,481)	57,691,740
General and Administrative Expenses	567,898	1,040,700	745,320
Total Operating Expenses	**36,452,033**	**(43,231,781)**	**58,437,060**
OPERATING INCOME (LOSS)	**(44,633)**	**76,458,809**	**(28,723,469)**
NONOPERATING REVENUES (EXPENSES), AND TRANSFERS			
Investment Income	67,517,498	54,074,633	67,930,959
Miscellaneous Revenue (Expense)	6,854	(681,860)	3,730
Net Income Before Transfers	67,479,719	129,851,582	39,211,220
Transfers:			
Transfers from the General Fund (Note 4)	0	31,159,316	202,587,765
Transfers to the General Fund (Note 9)	(16,525)	(15,323)	(14,046)
CHANGE IN NET ASSETS	**67,463,194**	**160,995,575**	**241,784,939**
NET ASSETS			
Net Assets—Beginning of the Year	293,798,420	132,802,845	(108,982,094)
Net Assets—End of the Year	$ 361,261,614	$ 293,798,420	$ 132,802,845

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2012, 2011, and 2010

	Year Ended June 30, 2012	Year Ended June 30, 2011	Year Ended June 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Received from Providers for Assessments	$ 34,853,293	$ 35,427,825	$ 29,538,806
Cash Received from Other Sources	341,388	466,604	424,602
Cash Paid for Losses	(1,211,182)	(33,584,200)	(4,879,712)
Cash Paid for Loss Adjustment Expenses	(3,867,772)	(4,874,519)	(4,585,068)
Cash Paid for Future Medical Expenses	(1,472,998)	(1,787,542)	(2,472,169)
Cash Paid for Other Expenses	(843,823)	(896,493)	(861,140)
Cash Paid to Providers for Refunds of Assessments	(365,968)	(371,324)	(462,596)
Cash Paid for Medical Mediation Panel Fees	(364,946)	(383,561)	(354,919)
Net Cash Provided by (Used for) Operating Activities	**27,067,992**	**(6,003,210)**	**16,347,804**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Principal Payments for State Investment Fund Loan	0	0	(76,778,323)
Interest Payments for State Investment Fund Loan	0	0	(95,109)
Receipt of Advance to Medical Assistance Trust Fund Repayment (Note 4)	233,747,081	0	0
Payment to Wisconsin Medical Society (Note 4)	(691,106)	0	0
Transfers to the General Fund	(16,363)	(15,323)	(14,046)
Net Cash Provided by (Used for) Noncapital Financing Activities	**233,039,612**	**(15,323)**	**(76,887,478)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Cash Paid to Develop the Fund's Provider System	(116,821)	(77,429)	(331,921)
Net Cash Provided by (Used for) Capital and Related Financing Activities	**(116,821)**	**(77,429)**	**(331,921)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest Received	29,829,628	28,061,121	29,279,035
Cash Received as Proceeds from Sales of Investments	40,777,688	78,357,915	90,414,152
Cash Paid for Purchase of Investment Securities	(303,529,488)	(106,818,544)	(5,406,111)
Net Cash Provided by (Used for) Investment Activities	**(232,922,172)**	**(399,508)**	**114,287,076**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**27,068,611**	**(6,495,470)**	**53,415,481**
Cash and Cash Equivalents—Beginning of the Year	46,920,011	53,415,481	0
Cash and Cash Equivalents—End of the Year	$ 73,988,622	$ 46,920,011	$ 53,415,481

The accompanying notes are an integral part of this statement.

	Year Ended June 30, 2012	Year Ended June 30, 2011	Year Ended June 30, 2010
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES			
Operating Income	$ (44,633)	$ 76,458,809	$ (28,723,469)
Adjustments to Reconcile Operating Income to			
Net Cash Provided by Operating Activities:			
Depreciation Expense	35,643	27,290	4,360
Changes in Assets and Liabilities:			
Decrease (Increase) in Assessments Receivable	4,334	(244,926)	71,567
Decrease (Increase) in Other Assets	453	18,887	(14,640)
Increase (Decrease) in Loss Liabilities	29,274,793	(84,568,138)	45,664,813
Increase (Decrease) in Other Liabilities	(2,202,598)	2,304,868	(654,827)
Total Adjustments	27,112,625	(82,462,019)	45,071,273
Net Cash Provided by (Used for) Operating Activities	**$ 27,067,992**	**$ (6,003,210)**	**$ 16,347,804**
Noncash Activities:			
Net Change in Unrealized Gains (Losses)	$ 37,603,405	$ 26,551,321	$ 40,879,007
Amortization of Bond Discounts	(2,579,122)	(641,335)	(948,696)
Establishment and Increase in Advance to the Medical Assistance Trust Fund	0	31,159,316	202,587,765

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ▪

1. Description of the Fund

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

Management of the Fund is vested with the 13-member Board of Governors, which is chaired by the Commissioner of Insurance. The Board has designated the Commissioner of Insurance as the administrator of the Fund. Similarly, under s. 655.27(2), Wis. Stats., the Commissioner shall either provide staff services necessary for the operation of the Fund or, with the approval of the Board, contract for all or part of these services. During FY 2011-12, FY 2010-11, and FY 2009-10, the Board contracted for the Fund's actuarial, risk management, and claims administration services.

2. Summary of Significant Accounting Policies

A. Fund Accounting and Basis of Presentation

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

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

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

The Fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure. Further, the Fund has not elected to apply the provisions of relevant pronouncements of FASB issued after November 30, 1989.

B. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant changes in future years are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 5 on ultimate and discounted loss liabilities.

C. Cash and Cash Equivalents

Cash and cash equivalents include cash balances deposited with the State and shares in the State Investment Fund, which is a short-term pool of state and local funds. The State Investment Fund shares are included in both the current portion of cash and cash equivalents and noncurrent portion restricted for future medical expenses.

D. Investment Valuation

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

E. Assessments

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

F. Loss Liabilities

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

G. Policy Acquisition Costs

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

H. Capital Assets

The Fund capitalizes all assets, both tangible and intangible, which have a historic cost or estimated historic cost in excess of $5,000 and a useful life of two or more years. As of June 30, 2012, June 30, 2011, and June 30, 2010, the Fund's only capital asset consisted of the internally developed provider system software. This software is depreciated on a straight-line basis over fifteen years.

I. Net Assets

Section 655.27(6), Wis. Stats., requires the Injured Patients and Families Compensation Fund to be held in an irrevocable trust and used for future claim payments for injured patients and families. Available net assets are restricted for injured patients and families and totaled $360,794,263 as of June 30, 2012, $293,420,720 as of June 30, 2011, and $132,475,284 as of June 30, 2010.

J. Employee Compensated Absences

The 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. The compensated absences liability is classified as either a short-term liability under general and administrative expenses payable or a long-term liability under compensated absences and OPEB liabilities based upon an estimate determined by management. The long-term liability portion of the compensated absences liability generally is not paid out until retirement.

3. DEPOSITS AND INVESTMENTS

The Fund's deposits consist of cash deposited in the State's bank, which totaled $90,622 as of June 30, 2012, $290,011 as of June 30, 2011, and $88,481 as of June 30, 2010.

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

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

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

	June 30, 2012	June 30, 2011	June 30, 2010
Short-term Investment Pool:			
State Investment Fund[1]	$ 73,898,000	$ 46,630,000	$ 53,327,000
Fixed-Income:			
U.S. Government and Agency	294,943,115	198,018,956	195,718,162
Industrial	234,420,591	191,535,395	165,319,819
Transportation	26,784,710	12,473,080	12,439,608
Finance	109,067,786	47,737,620	52,405,685
Utilities	113,854,792	73,567,080	58,462,560
Sovereign	0	5,673,146	5,583,166
Subtotal	779,070,994	529,005,277	489,929,000
Equities:			
Russell 2000 Index Fund	13,495,673	9,811,913	7,258,690
S & P 500 Index Fund	119,290,322	81,734,020	72,010,009
S & P 400 Index Fund	11,282,621	8,192,452	7,116,126
MSCI World Ex-US Index Fund	21,153,299	17,346,003	15,274,615
Subtotal	165,221,915	117,084,388	101,659,440
Total	$1,018,190,909	$692,719,665	$644,915,440

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

Custodial Credit Risk - Deposits—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Fund will not be able to recover deposits that are in possession of an outside party. The Fund does not have a deposit policy specifically for custodial credit risk. None of the Fund's bank balances as of June 30, 2012, June 30, 2011, and June 30, 2010, were exposed to custodial credit risk.

Custodial Credit Risk - Investments—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investments that are in possession of an outside party. The Fund does not have an investment policy specifically for custodial credit risk. As of June 30, 2012, June 30, 2011, and June 30, 2010, the Fund did not have any investments exposed to custodial credit risk.

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

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

	June 30, 2012		June 30, 2011		June 30, 2010	
	Fair Value	Percentage	Fair Value	Percentage	Fair Value	Percentage
Credit Rating:						
AAA	$ 19,038,197	2.2%	$211,436,535	36.7%	$204,662,584	37.7%
AA	323,223,113	37.9	21,181,114	3.7	16,399,815	3.0
A	292,889,207	34.3	197,275,344	34.3	154,732,476	28.5
BBB	131,005,561	15.4	79,625,334	13.8	91,428,688	16.8
BB	9,529,916	1.1	14,993,200	2.6	19,380,437	3.6
B	3,375,000	0.4	4,487,500	0.8	3,300,000	0.6
C or Lower	0	0.0	0	0.0	0	0.0
Not Rated	10,000	0.0	6,250	0.0	25,000	0.0
Subtotal	779,070,994	91.3	529,005,277	91.9	489,929,000	90.2
State Investment Fund (unrated)[1]	73,898,000	8.7	46,630,000	8.1	53,327,000	9.8
Total	$852,968,994	100.0%	$575,635,277	100.0%	$543,256,000	100.0%

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

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 Fund's investment guidelines do not allow for investments in any one single issuer that are in excess of 5.0 percent of the Fund's bond portfolio based on market value at the time of purchase. Securities of the United States government and its agencies are excluded from that limitation. As of June 30, 2012, June 30, 2011, and June 30, 2010, the Fund did not have more than 5.0 percent of its total investments in a single issuer, excluding the United States government and its agencies. Concentration of credit risk requirements are also not applicable to pooled investments, such as the State Investment Fund.

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

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

	June 30, 2012		June 30, 2011		June 30, 2010	
	Fair Value	Duration (In Years)	Fair Value	Duration (In Years)	Fair Value	Duration (In Years)
Type of Security:						
Government/Agency	$294,943,115	5.28	$198,018,956	5.39	$195,718,161	4.72
Corporate	484,127,879	5.85	330,986,321	5.61	294,210,839	5.43
Subtotal	779,070,994	5.64	529,005,277	5.52	489,929,000	5.15
State Investment Fund[1]	73,898,000	0.21	46,630,000	0.20	53,327,000	0.21
Total	$852,968,994	5.17	$575,635,277	5.09	$543,256,000	4.66

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

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2012, June 30, 2011, and June 30, 2010, the Fund did not directly own any issues denominated in a foreign currency.

4. 2007 Wisconsin Act 20 Lawsuit Activities

2007 Wisconsin Act 20 required the Injured Patients and Families Compensation Fund to transfer to the Medical Assistance Trust Fund a total of $200 million, which it did during FY 2007-08 and FY 2008-09. The Wisconsin Medical Society filed a lawsuit on behalf of its members challenging the transfer. In July 2010, the Wisconsin Supreme Court ruled that the $200.0 million transfer pursuant to 2007 Wisconsin Act 20 was unconstitutional and remanded the case back to the Dane County Circuit Court to issue an order on the repayment of the money transferred together with lost investment earnings and interest that had been charged to the Fund. As a result, in FY 2009-10 the Fund accrued a transfer from the General Fund and a noncurrent advance to the Medical Assistance Trust Fund of $202,587,765 from the General Fund in anticipation of the known repayment of the $200 million and $2,587,765 of interest paid by the Fund because of related cash flow issues.

In July 2011, the Dane County Circuit Court signed an order directing the State to transfer a total of $233,747,081 to the Fund on or before October 1, 2011. The Fund recorded the additional $31,159,316 of the settlement, which represented the Fund's estimated lost investment earnings and attorney fees to be paid to the Wisconsin Medical Society, as a transfer from the General Fund and an increase to the advance to the Medical Assistance Trust Fund during FY 2010-11. In August 2011, $233,747,081 of cash was transferred from the General Fund to the Fund. As part of the Dane County Circuit Court ruling, the Fund was required to pay $691,106 in attorney fees to the Wisconsin Medical Society within five days of receiving the transfer from the General Fund. The Fund accrued the fees as a miscellaneous nonoperating expense during FY 2010-11, and made the payment in August 2011.

5. TOTAL LOSS LIABILITIES

A. Estimated Loss Liabilities

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

	June 30, 2012	June 30, 2011	June 30, 2010
Projected Ultimate Loss Liability	$1,448,982,159	$1,427,708,557	$1,484,313,138
Less:			
Net Losses Paid from Inception	(809,624,293)	(810,105,943)	(772,631,942)
Liability for Reported Losses	(20,146,674)	(7,149,424)	(56,028,392)
Liability for IBNR Losses	$ 619,211,192	$ 610,453,190	$ 655,652,804

The Fund's consulting actuary developed a best estimate of the loss liabilities, and the Board of Governors approved the addition of an explicit 25.0 percent risk margin to the best estimate for June 30, 2012, June 30, 2011, and June 30, 2010. The explicit risk margin is applied to ensure that the loss liability estimates remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments.

Loss liabilities also include a provision for the estimated future payment of costs to settle claims. The actuary estimates the ultimate loss adjustment expense (LAE) using data available through September 30 of the fiscal year. The actuary estimates LAE at 18.0 percent of the estimated unpaid loss liabilities as of June 30, 2012, June 30, 2011, and June 30, 2010. Because the actuary's estimate occurs before the end of the fiscal year and is based on an estimate of the cumulative payments, the percentage used by the actuary in determining the LAE will differ slightly from the percentages calculated using actual LAE payments in the financial statements. The LAE paid from inception of the Fund are deducted from the projected ultimate LAE provision to arrive at the liability for LAE as follows:

	June 30, 2012	June 30, 2011	June 30, 2010
Projected Ultimate LAE Liability	$190,818,020	$184,300,028	$194,766,945
Less:			
Net LAE Paid from Inception	(78,587,167)	(74,719,395)	(69,848,051)
Liability for LAE	$112,230,853	$109,580,633	$124,918,894

B. Re-estimated Loss Liabilities

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

C. Discounted Loss Liabilities

Section Ins. 17.27(3), Wis. Adm. Code, requires the liability for reported losses, liability for IBNR losses, and liability for LAE to be maintained on a present-value basis, with the difference from full value being reported as a contra account to the loss liabilities. The loss liabilities are discounted only to the extent that they are matched by cash and invested assets. The actuarially determined discount factors, which are based on investment yield assumptions of 5.0 percent for FY 2011-12 and 5.5 percent for FY 2010-11 and FY 2009-10 that are approved by the Board of Governors, were 0.841 for FY 2011-12, 0.824 for FY 2010-11, and 0.820 for FY 2009-10.

D. Future Medical Expense Liability

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

E. Contributions Being Held Liability

A primary insurer may voluntarily present a nonrefundable payment to the Fund generally equal to the amount of primary coverage in effect for the related claim. This payment from the primary insurer is negotiable with the Fund in exchange for a release of payment for any future defense costs that may be incurred on the claim. This amount is held as a liability on the Fund's financial statements until the time a payment is made on the claim. No contributions were being held as of June 30, 2012, June 30, 2011, and June 30, 2010.

F. Loss Liabilities Balances and Activities

	FY 2011-12	FY 2010-11	FY 2009-10
Total Loss Liabilities, Beginning of the Year	$636,503,075	$721,071,213	$675,406,400
Incurred Losses and Related Expenses for the Current Year and Changes in the Estimated Liabilities for Prior Year Losses and Related Expenses	35,826,745	(44,321,877)	57,601,762
Less: Current Year Payments for Losses, LAE, and FME Incurred in the Current and Prior Years	(6,551,952)	(40,246,261)	(11,936,949)
Total Loss Liabilities, End of the Year	665,777,868	636,503,075	721,071,213
Less: Current Portion	(82,214,231)	(79,816,675)	(86,334,986)
Noncurrent Portion	$583,563,637	$556,686,400	$634,736,227

6. MEDICAL MEDIATION PANEL FEES

Section Ins. 17.27(3), Wis. Adm. Code, requires the fees collected for administration of the Medical Mediation Panel to be included in the Fund's financial reports, but that they should not be regarded as assets or liabilities of the Fund or otherwise taken into consideration in determining assessment levels to pay claims. The Fund remitted panel fees to the Wisconsin Supreme Court of $364,946 in FY 2011-12, $383,561 in FY 2010-11, and $354,919 in FY 2009-10.

7. CLAIM ANNUITIES

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

One of the Fund's annuity providers defaulted on $106,038 in annuity payments through June 30, 2012, which the Fund subsequently paid. The annuity provider is currently making the majority of these annuity payments, but the Fund continues to make monthly annuity payments of $130, and additional lump-sum payments due every five years through 2025, to cover defaulted payments. Through June 30, 2012, the Fund has received a total reimbursement of $92,797, which includes interest. It is unclear when the annuity provider will be able to make the remaining annuity payments and whether the Fund will be able to recover the remaining annuity payments made on the behalf of the annuity provider.

The total estimated replacement value of the Fund's annuities of which the Fund remains the owner was $32.8 million as of June 30, 2012, June 30, 2011, and June 30, 2010. Of this amount, $651,753 represents the replacement value of the annuity in default as of June 30, 2012.

8. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

As permanent full-time employees of the State of Wisconsin, Fund employees are participants in the Wisconsin Retirement System (WRS), a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. Contributions that the Fund pays to WRS are included as part of general and administrative expenses and totaled $36,699 for FY 2011-12, $60,713 for FY 2010-11, and $55,838 for FY 2009-10. The relative position of the Fund in the WRS System is not available because the WRS is a statewide, multiple-employer plan.

In accordance with GASB issued Statement No. 45, the State is required to report other postemployment benefit (OPEB) expenses, which the Fund reports as part of general and administrative expenses. OPEBs include an implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the State's health insurance program and postemployment coverage in the State's life insurance program. Included as part of the noncurrent compensated absences and OPEB liabilities account on the Statement of Net Assets, OPEB liabilities were $39,251 as of June 30, 2012, $39,199 as of June 30, 2011, and $31,741 as of June 30, 2010.

Copies of the separately issued financial reports for the WRS System and the life insurance program are available on the Department of Employee Trust Funds' website, *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 website, *http://www.doa.wi.gov.*

9. TRANSFERS OUT TO THE GENERAL FUND

Sections 9101(9) and (9q) of 2003 Wisconsin Act 33 gave the State of Wisconsin authority to issue annual appropriation bonds to pay off certain unfunded liabilities in the pension and other employee benefit programs, resulting in cost savings to the State. Section 16.529, Wis. Stats., requires state agencies to make certain transfers to the General Fund for this purpose, which included all of the balance of this account for the Injured Patients and Families Compensation Fund for FY 2011-12, FY 2010-11, and FY 2009-10.

10. AUDIT ADJUSTMENTS

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

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Report on Internal 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 Injured Patients and Families Compensation Fund as of and for the years ended June 30, 2012, June 30, 2011, and June 30, 2010, and have issued our report thereon dated February 19, 2013. 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

Management of the Wisconsin Injured Patients and Families Compensation Fund is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits, we considered the Wisconsin Injured Patients and Families Compensation Fund's internal control as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Wisconsin Injured Patients and Families Compensation Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Wisconsin Injured Patients and Families Compensation Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the following paragraphs, we identified a certain deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the Wisconsin Injured Patients and Families Compensation Fund's financial statements will not be prevented or will not be detected and corrected on a timely basis. We consider the deficiency described below related to the lack of adequate procedures and controls to ensure the accuracy of the Wisconsin Injured Patients and Families Compensation Fund's financial statements to be a material weakness.

As discussed in the audit report section titled "Need for Improvements in Financial Reporting," we identified material errors in the Wisconsin Injured Patients and Families Compensation Fund's draft financial statements for fiscal year (FY) 2010-11 and FY 2011-12. Loss liabilities and related underwriting expenses were materially misstated in both years. We also found several amounts in the draft cash flow statements misstated. We reported concerns with financial reporting errors in our previous audit (report 10-4). Although the Office of the Commissioner of Insurance indicated at that time that it would implement improvements to its financial reporting process, sufficient improvements were not made. In its response to our current audit, which follows the Appendix, the Office of the Commissioner of Insurance agrees to implement the recommended procedures as part of its corrective action plan to ensure the Wisconsin Injured Patients and Families Compensation Fund financial statements are complete and accurate. The Office of the Commissioner of Insurance also plans to implement additional procedures, such as reviews by another accountant and additional consultation with the Fund's actuary to confirm the accuracy of the loss liabilities.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency with the Wisconsin Injured Patients and Families Compensation Fund's provider system that was reported in our previous audit (report 10-4) to be a significant deficiency for FY 2009-10. The Office of the Commissioner of Insurance implemented a new provider system in March 2010, which addressed this concern.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Wisconsin Injured Patients and Families Compensation 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 written response of the Office of the Commissioner of Insurance to the financial reporting deficiency identified in our audit follows the Appendix and is described in the preceding paragraphs. We did not audit the Office of the Commissioner of Insurance's response and, accordingly, express no opinion on it.

We noted certain additional matters that we reported to the Office of the Commissioner of Insurance in separate communications dated October 5, 2012, November 22, 2011, and November 1, 2010.

This independent auditor's report is intended solely for the information and use of the Wisconsin Injured Patients and Families Compensation Fund's management within the Office of the Commissioner of Insurance, the Board of Governors, and the Wisconsin Legislature. This 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 Injured Patients and Families Compensation 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

February 19, 2013 by Diann Allsen

Diann Allsen
Audit Director

Appendix

Annual Provider Assessments[1]

Provider Types	Fiscal Year							
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Physician Class 1[2]	$ 859	$1,074	$1,128	$1,128	$1,240	$1,347	$1,461	$ 1,534
Physician Class 2[3]	1,546	1,933	2,030	2,030	2,231	2,423	2,629	2,760
Physician Class 3[4]	3,565	4,457	4,681	4,681	5,144	5,387	5,844	6,136
Physician Class 4[5]	5,154	6,444	6,768	6,768	7,438	8,888	9,643	10,125
Nurse Anesthetist	211	264	277	277	304	330	358	376
Hospital—per Occupied Bed	52	65	68	68	75	81	88	92
Nursing Home—per Occupied Bed	10	13	14	14	15	16	18	19
Employees of a Partnership or Corporation:								
Nurse Practitioner	215	269	282	282	310	337	365	383
Advanced Nurse Practitioner	301	376	395	395	434	471	511	537
Nurse Midwife	1,890	2,363	2,482	2,482	2,728	2,963	3,214	3,375
Advanced Nurse Midwife	1,976	2,470	2,594	2,594	2,851	3,096	3,359	3,527
Advanced Practice Nurse Prescriber	301	376	395	395	434	471	511	537
Chiropractor	344	430	451	451	496	539	584	613
Dentist	172	215	226	226	248	269	292	307
Oral Surgeon	1,289	1,611	1,692	1,692	1,860	2020	2,192	2,302
Podiatrists—Surgical	3,651	4,565	4,794	4,794	5,269	5,722	6,209	6,519
Optometrist	172	215	226	226	248	269	292	307
Physician Assistant	172	215	226	226	248	269	292	307

[1] These rates apply to providers having Wisconsin as their primary place of practice. Other rates apply to providers for whom Wisconsin is not the primary place of practice.

[2] Includes family or general practice physicians not performing surgery, and nutritionists.

[3] Includes family or general practice physicians performing minor surgery, and ophthalmologists performing surgery.

[4] Includes most types of surgeons, such as plastic, hand, general, and orthopedic.

[5] Includes obstetric and neurological surgeons.

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Injured Patients and Families Compensation Fund
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Scott Walker, *Governor*
Theodore K. Nickel, *Commissioner*

Wisconsin.gov

February 27, 2013

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

Dear Mr. Chrisman:

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

We recommend the Office of the Commissioner of Insurance work with the Board of Governors to establish a target range of minimum and maximum net asset balances for the Injured Patients and Families Compensation Fund to maintain and to establish a process to evaluate the appropriateness of the targets on an annual basis.

The Board of Governors (Board) of the Injured Patients and Families Compensation Fund (Fund) recognizes that the Fund is presently in a financial position in which there is a healthy balance. The focus has now shifted to the management of this balance. The Office of the Commissioner of Insurance (OCI) will ask the Board to work with its contracted actuary to determine whether there is a reasonable range to target minimum and maximum net asset balances while maintaining the overall sufficiency of the Fund, and also establish a process to annually evaluate the appropriateness of the targets.

The Board has already started to address the issue in consultation with the actuary for the Fund. In December, 2012, the Board approved a 5.0 percent decrease in assessment rates for fiscal year 2013-14. This reduction followed three years of assessment rate increases. The decrease establishes lower than actuarially indicated assessment rates, with an expected reduction in the net asset balance over a period of years with the goal of merging a desired net asset balance with adequate assessment rates.

We recommend the Office of the Commissioner of Insurance reassess the Injured Patients and Families Compensation Fund's current financial reporting process and take steps to establish and document clear procedures for completing and verifying the accuracy of the Fund's financial statements, including:

- ***obtaining a full understanding of the Fund's financial activities, developing corresponding expectations for the Fund's financial accounts, comparing actual results to expectations, and following up on differences;***

- ***reconciling and verifying key account balances to supporting or corroborating sources of information, such as reconciling investment balances and activities to information provided by the State of Wisconsin Investment Board;***

- ***reviewing the continued accuracy of formulas and links in spreadsheets used in the preparation of financial statements; and***

- ***establishing checklists to document that critical steps are completed in preparation and review of the financial statements.***

The Office of the Commissioner of Insurance is committed to the sound, accurate and effective administration of the large and complex Fund. The agency recognizes the seriousness of the financial reporting issues identified, and it is our intent to take the steps necessary to address these issues moving forward.

The OCI is implementing changes in the financial reporting procedures and controls for the Fund as follows:

1. Financial statement procedures

    a. The Fund's procedures for financial reporting will be reviewed and updated as necessary in order to ensure the accuracy of the Fund's financial statements.
    b. A full understanding of the Fund's financial activities and financial statements will be obtained through review, analysis and additional training.
    c. Expectations, or projections, for the Fund's financial accounts will be developed, with comparison between actual results and expectations as well as follow-up regarding differences.

2. Data integrity

    a. A thorough review of the spreadsheets used in preparation of the financial statements will be completed to verify the accuracy of formulas and links. In addition, the programs used to retrieve data from Wismart will be reviewed to confirm that all necessary data is being retrieved for financial statement purposes.
    b. Reconciliation and verification of account balances to corroborating sources of information, including investment information to State of Wisconsin Investment Board reports, will be performed where not already done.

3. Financial statement review

    a. Checklists will be developed to document completion of key steps in both preparation and review of the financial statements. Deadlines for completion of these steps will be identified, as applicable.
    b. The Fund's actuary will be consulted to review and confirm the accuracy of loss liabilities.
    c. As an interim oversight step, OCI's accountant will provide additional analysis of the financial statements.

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

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

Sincerely,

Theodore K. Nickel
Commissioner of Insurance

TKN:lsc

Cc: Louis Cornelius, Insurance Administrator
Jeff Kohlmann, Insurance Program Manager