Report 10-4
March 2010

An Audit

Injured Patients and Families Compensation Fund

Office of the Commissioner of Insurance

LEGISLATIVE AUDIT BUREAU

The Bureau is a nonpartisan legislative service agency responsible for conducting financial and program evaluation audits of state agencies. The Bureau's purpose is to provide assurance to the Legislature that financial transactions and management decisions are made effectively, efficiently, and in compliance with state law and that state agencies carry out the policies of the Legislature and the Governor. Audit Bureau reports typically contain reviews of financial transactions, analyses of agency performance or public policy issues, conclusions regarding the causes of problems found, and recommendations for improvement.

Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau. For more information, write the Bureau at 22 East Mifflin Street, Suite 500, Madison, WI 53703, call (608) 266-2818, or send e-mail to leg.audit.info@legis.wisconsin.gov. Electronic copies of current reports are available at www.legis.wisconsin.gov/lab.

State Auditor – Janice Mueller

Audit Prepared by

Diann Allsen, *Director and Contact Person*
Brian Geib
Jeff Beckett
Monica Davie
Carrie Ferguson
Jenny Nielsen

Director of Publications – Jeanne Thieme
Report Design and Production – Susan Skowronski

CONTENTS

Appendices

Appendix 1—Annual Provider Assessments
Appendix 2—Claims Payments of $5 Million or More through December 31, 2009

Response

From the Office of the Commissioner of Insurance

STATE OF WISCONSIN
Legislative Audit Bureau

22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703
(608) 266-2818
Fax (608) 267-0410
www.legis.wisconsin.gov/lab

Janice Mueller
State Auditor

March 30, 2010

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

Dear Senator Vinehout and Representative Barca:

As required by s. 13.94(1)(de), Wis. Stats., we have completed a financial audit of the 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 the Office of the Commissioner of Insurance (OCI). We have provided an unqualified auditor's report on the Fund's financial statements for the fiscal years ending June 30, 2009, 2008, and 2007.

The Fund's financial position has declined significantly over the last two years. Its audited financial statements show negative net assets in the amount of -$109.0 million as of June 30, 2009. In 2007 Wisconsin Act 20, the Legislature directed that $200.0 million be transferred from the Fund to the Medical Assistance Trust Fund. The Injured Patients and Families Compensation Fund's financial position also has been affected by the recent downturn and instability in the economy and the investment markets. Further, the FY 2008-09 total of $65.7 million in annual claim payments was the largest since the Fund's inception.

As recommended in past audits, actuarial audits are being completed every three years. However, OCI failed to request an evaluation of the appropriateness of the explicit loss liability risk margin and the investment return assumption as part of its 2008 actuarial audit, as had been recommended in our 2007 financial audit. We again recommend that OCI address these two areas in the next actuarial audit.

The Fund's computerized provider system had required correction by regular manual reviews and adjustments. However, the Fund recently implemented a new system, at a total cost of $1.4 million. We will evaluate the adequacy of the new system as part of our next audit of the Fund.

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 appendices.

Respectfully submitted,

Janice Mueller

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ▪

The Fund's financial position has declined significantly.

A 2008 actuarial audit concluded the Fund's loss liability estimates were reasonable, although conservative.

OCI implemented a new provider system, at an estimated cost of $1.4 million.

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.

The Fund has paid more than $770.8 million in claims from its inception through December 31, 2009. There is no limit to the compensation it 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.

Statutes require the Legislative Audit Bureau to perform financial audits of the Fund at least once every three years. Our audit report contains our unqualified opinion on the Fund's financial statements and related notes as of and for the years ending June 30, 2009, 2008, and 2007. In light of ongoing interest in the Fund's financial position, we also reviewed changes in provider assessments, annual claim payments, and the Fund's accumulated cash and investments; recent legislation and court decisions affecting the Fund; and the results of an actuarial audit completed in 2008. In addition, we reviewed the status of the implementation of the Fund's new computer system for maintaining the accounts of participating providers.

Financial Position

Since its creation in 1975, the Fund has received more provider assessments and investment income than it has paid out in claims and administrative expenses. As a result, it accumulated $635.8 million in investments as of June 30, 2009.

However, 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. Both the uncertainty and the long-term nature of medical malpractice claims make it difficult to predict the size and timing of claims that will be settled and paid from the Fund. The Board of Governors, which manages the Fund, relies on a consulting actuarial firm to estimate the Fund's loss liabilities.

For several years, the Fund had reported a positive financial position because estimated loss liabilities were less than the cash and investments available to pay them. However, its financial balance has declined significantly over the last two years. The 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, as shown in Table 1.

Table 1

Audited Net Asset Balance[1]
As of June 30

Year	Amount (in millions)
2000	$ 27.2
2001	28.4
2002	6.6
2003	7.9
2004	24.6
2005	31.7
2006	59.8
2007	94.4
2008	(61.5)
2009	(109.0)

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

In 2007 Wisconsin Act 20, the Legislature directed that $200.0 million be transferred from the Fund to the Medical Assistance Trust Fund in the 2007-09 biennium. The transfer took place in two stages: $71.5 million was transferred in October 2007, and the remaining $128.5 million was transferred in July 2008. Because the Fund did not have sufficient cash and investments to readily liquidate without incurring a loss, the transfer caused its cash balance to become negative. The Fund had a negative cash balance in the amount of -$76.8 million as of June 30, 2009, and incurred interest expenses totaling $2.5 million through June 30, 2009.

The Wisconsin Medical Society filed a lawsuit in October 2007 challenging the constitutionality of the transfer. The lawsuit was dismissed in December 2008, but an appeal is currently pending before the Wisconsin Supreme Court.

The Fund's financial position also has been affected by the recent downturn and instability in the economy and the investment markets. The Fund incurred $9.2 million in realized and unrealized losses from the collapse of Washington Mutual Bank and Lehman Brothers Holdings, Inc., in 2008. The Fund also realized losses of $7.7 million from the sale of investments in Ford Motor Company and General Motors Corporation as the State of Wisconsin Investment Board—the entity that manages its investments—reduced the Fund's exposure to the auto industry.

The Fund has experienced a steady increase in annual claim payments over the last four years. The fiscal year (FY) 2008-09 total of $65.7 million in annual claim payments was the largest since the Fund's inception. The FY 2007-08 total of $50.5 million in annual claim payments was the second-largest. These amounts include deposits in accounts to fund the payment of future medical expenses. In June 2008, the Fund paid its largest claim to date, which was $34.3 million. The next-largest claim payment to date, which was $18.0 million, was paid in December 1990.

At least part of the increase in claim payments over the last four years can be attributed to a 2005 Wisconsin Supreme Court ruling that a $350,000 inflation-adjusted limit on noneconomic damages in medical malpractice cases violates equal protection guarantees in the Wisconsin Constitution. A new limit of $750,000 was enacted on April 6, 2006, but because of the Court's 2005 decision there were no limits on the recovery of noneconomic damages for incidents that occurred from January 1, 1991, through April 5, 2006.

The Fund's consulting actuary projects deterioration in the Fund's financial position over the next several years without fee increases. In response, the Board increased rates by 9.9 percent effective July 1, 2009.

Actuarial Audits

Estimating the Fund's loss liabilities is challenging because:

- claims that exceed the primary medical malpractice insurance thresholds established in statute 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.

Estimates of the Fund's loss liabilities have been regularly reduced over the last several years as claim experience was more favorable than expected. We recommended in past audits that the Fund obtain regular and comprehensive reviews of its actuaries' methods and assumptions for estimating loss liabilities. Such actuarial reviews or audits are fairly common for critical and complex actuarial analyses, such as those completed for the Fund.

Two actuarial audits completed by two different actuarial firms—the first in July 2005 and the second in September 2008—concluded that the Fund's loss liabilities were reasonable, although conservative. Both firms also recommended improvements to the process for estimating the Fund's loss liabilities.

The 2005 actuarial audit recommended that the analysis of the consulting actuary include an explicit loss liability risk margin to represent the risk that actual losses could be higher than predicted and consider a lower investment return assumption. In 2007, we recommended that the next actuarial audit again evaluate these areas and that the Board of Governors report the results of the audit to the Legislature. However, the 2008 actuarial audit did not evaluate the appropriateness of either the explicit loss liability risk margin or the investment return assumption.

The 2008 actuarial audit recommended that the actuary use a second method to estimate losses for recent years and reevaluate the effect on its analyses of a 1997 increase in the statutory threshold for Fund coverage to $1.0 million for each incident. The actuary implemented the recommendations and believes its current analyses are correspondingly less conservative than in the past.

Provider System

As discussed in past audit reports, a continuing challenge for the Fund had been the decreasing effectiveness of an aging computer system that maintained the accounts of participating health care providers. The provider system, which was developed in the early 1990s, was not able to accommodate the increasing demands of the Fund's operations.

In response to the critical nature of the provider system and the seriousness of noted concerns, the Office of the Commissioner of Insurance (OCI) began to develop and implement a new provider system in FY 2005-06. The new system was implemented in March 2010. Costs for the new system total $1.4 million and were paid by the Fund. As part of our next audit of the Fund, we will assess whether the new provider system adequately addresses past concerns.

Recommendation

Our recommendation again addresses the need for the Fund's Board of Governors to:

☑ require the next actuarial audit to evaluate the appropriateness of the Fund's explicit loss liability risk margin and its investment return assumption, and convey that information in its annual report to the Legislature (*p. 19*).

▪ ▪ ▪ ▪

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 and contracts with Liberty Mutual Group, formerly known as Wausau Insurance Companies, which was paid $1,140,302 for claims administration in FY 2008-09, and Marsh USA, Inc., which was paid $121,114 for risk management services in FY 2008-09. From 1978 through August 2007, the actuarial firm of Milliman, Inc., provided actuarial services to the Fund. Following a competitive procurement process, the actuarial firm of Pinnacle Actuarial Resources, Inc., was selected to provide actuarial services beginning in September 2007. Pinnacle was paid $76,353 in FY 2008-09 for its services.

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, 2009, 84.1 percent of the 13,431 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. Appendix 1 lists annual assessment rates for various providers from FY 2002-03 through FY 2009-10.

Assessment rates generally decreased from FY 2000-01 to FY 2005-06, as shown in Table 2. However, they increased by 25.0 percent in FY 2006-07, in response 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. After a new limit of $750,000 on noneconomic damages was enacted by the Legislature in 2006, increases in the assessment rates slowed to 5.0 percent for FY 2007-08, and there was no increase for FY 2008-09. In response to a recommendation from the Fund's consulting actuary that at least modest fee increases were needed, the assessment rates were increased by an average of 9.9 percent for FY 2009-10.

Table 2

Annual Percentage Changes to Provider Assessment Rates

Policy Year	Average Percentage Change in Assessment Rates Approved by Board	Assessment Revenues
FY 2000-01	(25.0)%	$36,795,064
FY 2001-02	(20.0)	29,555,966
FY 2002-03	(5.0)	29,463,735
FY 2003-04	5.0	32,064,990
FY 2004-05	(20.0)	26,547,016
FY 2005-06	(30.0)	18,930,808
FY 2006-07	25.0	24,074,232
FY 2007-08	5.0	25,442,565
FY 2008-09	0.0	26,184,712
FY 2009-10	9.9	Not available

The Fund has paid more than $770.8 million for 651 claims from its inception through December 31, 2009.

Medical malpractice claims may be filed years after incidents occur. Provider coverage is based on participation at the time an event resulting in a claim occurred, rather than when the claim is filed. The Fund has paid more than $770.8 million in claims from its inception through December 31, 2009.

Individual claim payments have ranged from $750 to $34.3 million. As shown in Table 3, 72.5 percent of paid claims have been for amounts less than $1.0 million. However, these 472 claims account for only 21.1 percent of the Fund's total claim payments through December 31, 2009. In contrast, the 33 claims with payments of $5.0 million or more represent 39.5 percent of the total claim payments. Appendix 2 provides additional information about claims with payments of $5.0 million or more.

Table 3

Paid Claims from the Fund's Inception through December 31, 2009

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	33	5.1%	$304,626,484	39.5%
At least $1.0 million but less than $5.0 million	146	22.4	303,905,703	39.4
Less than $1.0 million	472	72.5	162,240,140	21.1
Total	**651**	**100.0%**	**$770,772,327**	**100.0%**

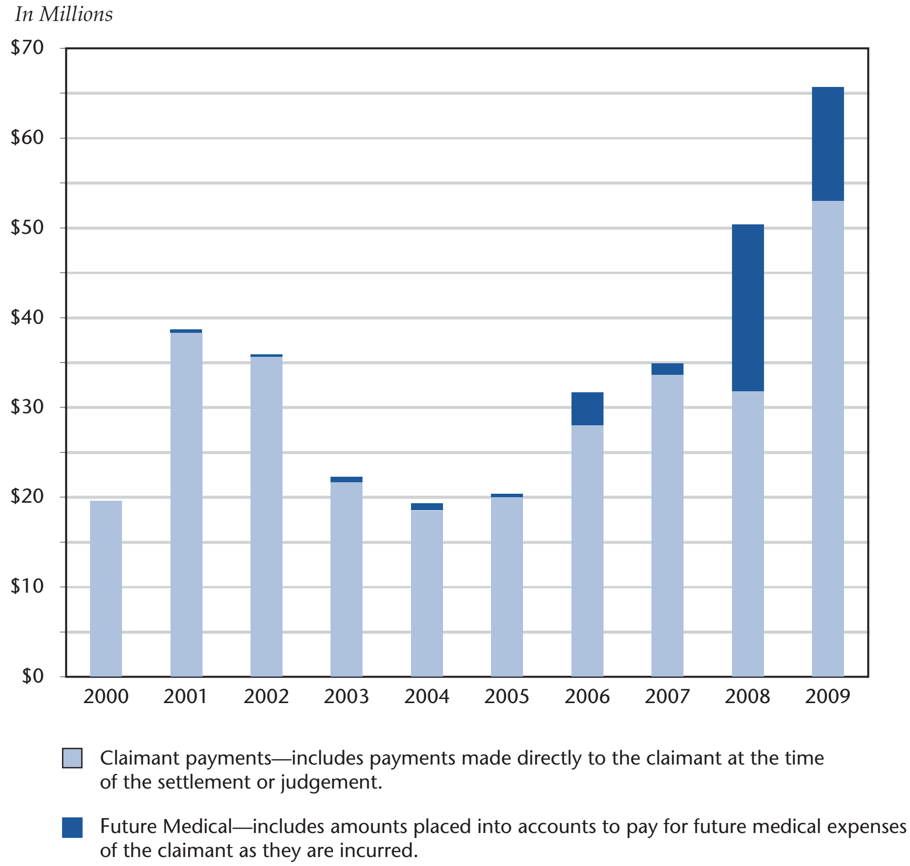
The Fund paid $65.7 million in claims in FY 2008-09.

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 claim payments can fluctuate from year to year, as shown in Figure 1. The Fund has experienced a steady increase in annual claim payments over the last four years. The FY 2008-09 total of $65.7 million in annual payments was the largest since the Fund's inception. The FY 2007-08 total of $50.5 million was the second-largest. Ten of the 33 claim payments of $5.0 million were made in the past three years, and five of these exceeded $9.0 million.

The recent increase in annual claim payments can be attributed, in part, to the severity of the claims being settled and the 2005 Wisconsin Supreme Court ruling on the constitutionality of the noneconomic damages limit. A new limit was enacted on April 6, 2006, but because of the Court's 2005 decision there were no limits on the recovery of noneconomic damages for incidents that occurred from January 1, 1991, through April 5, 2006. Nine of the ten large claim payments in the past three years were for claims that occurred while no limits on noneconomic damages were in effect. The average noneconomic damage award for these nine claims was $5.6 million, and the largest was $11.5 million.

Figure 1

Annual Claim Payments
For Fiscal Year Ending June 30



Although most of the annual claim payments included in Figure 1 were made directly to the claimant at the time of the settlement or judgment, Figure 1 also includes amounts placed in accounts to pay medical expenses as they are incurred in the future. 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. These accounts are managed by the Fund and earn proportionate shares of the Fund's interest. Any account balance remaining when a claimant dies reverts back to the Fund. The sum of the current 27 future medical expense accounts managed by the Fund is represented as a liability on the Fund's Statement of Net Assets.

The amount placed into new future medical accounts has increased significantly in recent years. For example, over the past three years, $31.0 million of $110.1 million in payments made for the ten largest claims was placed into future medical expense accounts, and in June 2008 the Fund paid $18.4 million to the recipient of its largest claim to date and placed the remaining $15.9 million into a future medical expense account for the claimant. The liability for the total of the future medical expense accounts increased from $5.5 million as of June 30, 2006, to $35.0 million as of June 30, 2009.

By law, the Legislative Audit Bureau is responsible for performing financial audits of the Injured Patients and Families Compensation Fund. As necessary parts of our financial audit, we reviewed the Fund's controls, assessed the fair presentation of its financial statements for FY 2008-09, FY 2007-08, and FY 2006-07, 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, patients and others who use 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 analysis, and the financial markets.

Financial Status of the Fund

The Fund accumulated $635.8 million in investments as of June 30, 2009.

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, the Fund accumulated $635.8 million in investments as of June 30, 2009, which are 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.

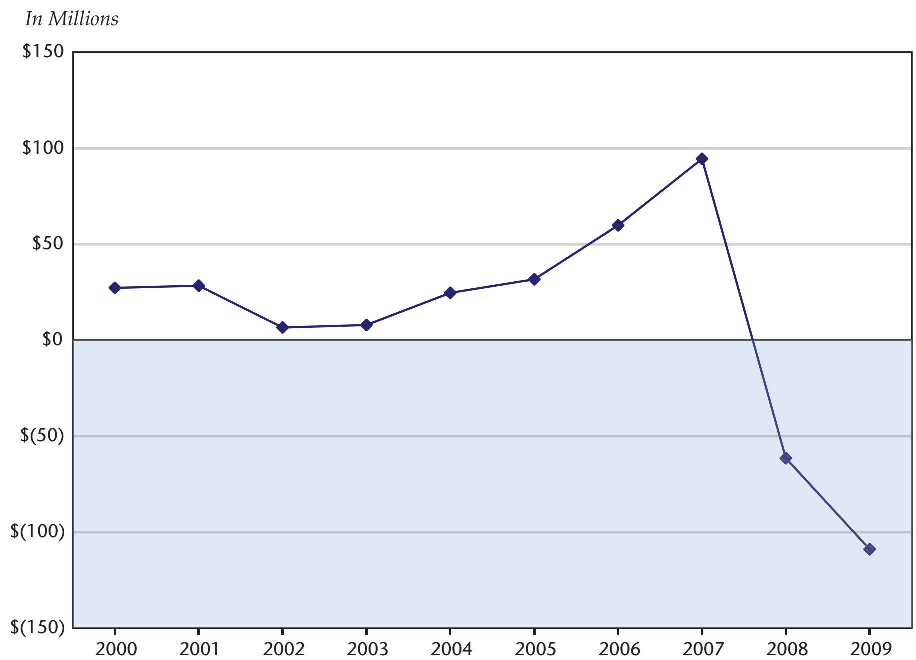
However, the Fund's financial position is also significantly affected by its loss liabilities, which are based on estimates of what it may be required to pay for malpractice incidents that have occurred but may not yet have been settled or even reported. The Board of Governors relies on the Fund's consulting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

The Fund reported a negative net asset balance in the amount of -$109.0 million, as of June 30, 2009.

The Fund's financial position is largely represented by its net asset balance, which is the difference between its assets and liabilities. For several years, the Fund reported a positive financial position. As shown in Figure 2, the net asset balance steadily increased from 2003 and totaled $94.4 million as of June 30, 2007. However, the net asset balance subsequently declined 215.5 percent and was a negative amount, -$109.0 million, as of June 30, 2009.

Figure 2

Audited Net Asset Balances[1]
As of June 30



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

The Fund transferred $200.0 million to the Medical Assistance Trust Fund in the 2007-09 biennium.

In 2007 Wisconsin Act 20, the Legislature directed that $200.0 million be transferred from the Fund to the Medical Assistance Trust Fund in the 2007-09 biennium. The transfer took place in two stages: $71.5 million was transferred in October 2007 and the remaining $128.5 million was transferred in July 2008.

Because the Fund did not have sufficient cash and investments it could readily liquidate without incurring a loss, the transfer caused its cash balance in the State Investment Fund to become negative. When a state fund has a negative cash balance, other state funds with positive balances in the State Investment Fund provide a temporary loan and the fund with the negative balance is assessed interest. The temporary loan is reported in the financial statements as a liability to the State Investment Fund. The Injured Patients and Families Compensation Fund had an outstanding temporary loan of $76.8 million as of June 30, 2009, and incurred $2.5 million in interest expense through June 30, 2009. The Fund attained a positive State Investment Fund balance of $3.9 million as of February 28, 2010.

Because the $200.0 million transfer resulted in a smaller cash and investment balance, it also reduces the Fund's potential future investment earnings. Further, because liabilities are "discounted" or reduced in the Fund's financial reports to take into account future investment returns, the loss of the future earnings is already affecting the Fund's financial position.

The Wisconsin Medical Society has challenged the constitutionality of the transfer.

The Wisconsin Medical Society filed a lawsuit in October 2007 challenging the constitutionality of the $200.0 million transfer. The lawsuit was dismissed in December 2008 by the Dane County Circuit Court, which concluded that the plaintiffs failed to meet their burden to show beyond a reasonable doubt that they have a protectable property interest in the Fund and the claims are otherwise barred based on the legal doctrine of sovereign immunity. The Medical Society appealed the Circuit Court's decision in March 2009, and the appeal is currently pending before the Wisconsin Supreme Court.

The Fund's financial position has also been affected by the recent downturn in the economy and instability in the investment markets, including the collapse of major financial institutions in 2008. It held $5.0 million investments in both Washington Mutual Bank, which entered into receivership, and Lehman Brothers Holdings, Inc., which entered into bankruptcy. The Washington Mutual Bank investment is valued at $2,500 as of June 30, 2009. The Investment Board sold the Fund's Lehman Brothers investment in June 2009 for a realized loss of $4.2 million. The Investment Board also sold $10.0 million in investments the Fund held in Ford Motor Company and General Motors Corporation in April 2009 at a realized loss of $7.7 million, to reduce the Fund's exposure to the uncertainty of the auto industry.

While the investments that the Fund currently holds can be used to meet current claim obligations, the Board of Governors is closely monitoring the revenues and assets of the Fund in light of recent events. The actuary projects that the Fund will likely experience deterioration in its financial position over the next several years without fee increases. As noted, the Board increased assessment rates by an average of 9.9 percent for FY 2009-10.

Actuarial Estimates of Loss Liabilities

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

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 Fund's 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 actuaries have regularly reduced past estimates of the Fund's loss liabilities because claim experience has been more favorable than originally expected. For example, in estimating liabilities as of June 30, 2009, Pinnacle reduced previously reported liabilities for the years before FY 2008-09 by $192.1 million, based on the additional year of experience.

Actuarial audits are completed every three years.

In response to prior audit recommendations, the Board 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 assesses the reasonableness of the actuarial methodology and assumptions used in developing estimates of the Fund's loss liabilities. Two actuarial audits have been completed by two different actuarial firms: the first in July 2005 and the second in September 2008. Both actuarial firms concluded that the Fund's loss liabilities were reasonable, although conservative. Both firms also recommended improvements to the process for estimating the Fund's loss liabilities.

The Fund failed to address a recommendation in our 2007 audit.

In our prior audit (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. We also recommended that the Board of Governors report the results of the actuarial audit in an annual report to the Legislature, which is required by s. 655.27(4)(f), Wis. Stats. However, the September 2008 actuarial audit did not address the appropriateness of either the explicit loss liability risk margin or the investment return assumption, as recommended. Further, in its annual reports to Legislature, the Board of Governors did not report on any of the results of the September 2008 actuarial audit or explain why the audit did not address the explicit loss liability risk margin and investment return assumption. During the course of our fieldwork, the Fund's management indicated that its failure to address the audit recommendation in our 2007 audit report was an oversight.

The 2008 actuarial audit recommended additional improvements to the actuarial process.

While the 2008 actuarial audit did not address the appropriateness of the explicit loss liability risk margin and investment return assumption, it did offer recommendations for further improvement in the actuarial analyses. The actuarial audit recommended that Pinnacle use a second method to estimate ultimate losses for recent years and reevaluate the effect on its analyses of a 1997 increase in the statutory threshold for Fund coverage to $1.0 million for each incident. Further, the actuarial audit recommended that, at some point, Pinnacle consider making an adjustment in its analysis to address the limit on noneconomic damages established in 2006.

Pinnacle implemented all of the 2008 actuarial audit recommendations in developing its estimates of the Fund's loss liabilities as of June 30, 2009. Pinnacle believes its analyses are correspondingly less conservative than in the past.

☑ Recommendation

We again recommend the Board of Governors' next request for an actuarial audit include specific provisions to evaluate the appropriateness of the Injured Patients and Families Compensation Fund's explicit loss liability risk margin and investment assumption, and that the Board report on the results of the actuarial audit in its annual report to the Legislature, which is required by s. 655.27(4)(f), Wis. Stats.

Provider System

As discussed in past audit reports, a continuing challenge for the Fund had been the decreasing effectiveness of an aging computer system. The system was developed in the early 1990s to track medical malpractice claims. Since that time, it had been expanded to maintain the accounts of participating health care providers, including billing and primary insurance coverage information.

The provider system had not been able to accommodate the increasing demands of the Fund's operations, which have become more complex over time. As a result, errors occurred in health care providers' accounts and required the Fund's staff to implement manual procedures to detect system problems.

In response to the critical status of the provider system and the seriousness of the noted concerns, OCI began to develop and implement a new provider system in FY 2005-06. It funded the initial development work through existing budget authority. In 2007 Wisconsin Act 20, OCI received additional budget authority of $599,400 for the continued development and ongoing maintenance of the new provider system through June 30, 2009. OCI's base budgetary authority for subsequent biennium includes $274,600 for ongoing system maintenance.

The Fund implemented a new provider system at an estimated cost of $1.4 million.

OCI implemented the new system in March 2010. OCI estimates $1.4 million in total expenditures for the development and implementation of the new system, which were paid for by the Fund. As part of our next audit of the Fund, we will assess whether the new provider system adequately addresses the concerns identified in the current system.

▪ ▪ ▪ ▪

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, 2009, 2008, and 2007, as listed in the table of contents. These financial statements are the responsibility of the management of the Wisconsin Injured Patients and Families Compensation Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 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 and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin Injured Patients and Families Compensation Fund as of June 30, 2009, 2008, and 2007, 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 to the financial statements, 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 management and Board of Governors believe that the estimated loss liabilities are reasonable and adequate to cover the cost of claims incurred as of the end of the fiscal year. 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.

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 23 through 31 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 15, 2010, 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.

LEGISLATIVE AUDIT BUREAU

March 15, 2010 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, 2009, 2008, and 2007. 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 State Medical Society of Wisconsin; 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 14.0 percent of total investments as of June 30, 2009, 16.0 percent as of June 30, 2008, and 18.4 percent as of June 30, 2007, 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 has been some fluctuation in total assets over the last three years. The increase from June 30, 2006, to June 30, 2007, occurred because assessment revenue and investment income exceeded paid losses and other cash expenses. The decreases from June 30, 2007, to June 30, 2008, and from June 30, 2008, to June 30, 2009, can be largely attributed to the decline in the financial markets and a $200.0 million transfer from the Fund to the Medical Assistance Trust Fund pursuant to 2007 Wisconsin Act 20. Transfers of $128.5 million in FY 2008-09 and $71.5 million in FY 2007-08 created a negative balance in the Fund's State Investment Fund account so all maturing securities are being used to pay down the negative State Investment Fund balance and to pay claims and other expenses. There also has been a significant increase in the dollar amounts of claims paid. The Fund paid an all-time high of approximately $65.7 million in claims in FY 2008-09, of which $12.7 million was placed into future medical expense accounts.

Table A

Total Assets

As of:	Total Assets	Change from Prior Year
June 30, 2009	$645,148,643	(16.3)%
June 30, 2008	771,071,985	(3.4)
June 30, 2007	798,488,611	7.0
June 30, 2006	746,386,079	–

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:	Total Loss Liabilities	Change from Prior Year
June 30, 2009	$675,406,400	(15.2)%
June 30, 2008	796,464,607	13.5
June 30, 2007	701,998,695	2.5
June 30, 2006	684,967,487	–

Section Ins. 17.27(3), Wis. Adm. Code, requires the liability for losses and loss adjustment expenses to be maintained on a present value basis. The discount factors for FYs 2008-09, 2007-08, and 2006-07 were 0.812, 0.810, and 0.753, respectively. Changes in the discount factor affect the amount representing the interest liability account, and the change in that account, which is reflected as an underwriting expense, is affected not only by the change in the discount factor but also by the amount of the estimated liability being discounted and available assets.

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 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 enactment of 2005 Wisconsin Act 183 in April 2006 established a limit of $750,000 for noneconomic damages. That limit affects claims arising out of incidents that occur on or after April 6, 2006. The legislation did not affect claims with incident dates prior to April 6, 2006. The majority of claim payments between 2006 and 2009 were for losses that occurred before April 6, 2006.

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.

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:	Net Assets	Change from Prior Year
June 30, 2009	$(108,982,094)	(77.2)%
June 30, 2008	(61,489,660)	(165.1)
June 30, 2007	94,408,525	57.7
June 30, 2006	59,848,012	–

The significant decrease in net assets in 2008 and 2009 was largely a result of the transfer of $200.0 million pursuant to 2007 Wisconsin Act 20, as well as a significant decrease in the value of investments the Fund held, which resulted from the financial market decline.

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 fluctuated a great deal over the last four years. Contributing factors included changes in assessment rates, significant changes in the investment markets that affected the value of the investments, and the negative State Investment Fund balance, which has resulted in the loss of investment earnings and payment of interest on the temporary loan through the State Investment Fund.

Table D

Total Revenues

Fiscal Year	Total Revenues	Change from Prior Year
2008-09	$22,814,166	(57.2)%
2007-08	53,358,103	(42.3)
2006-07	92,437,259	257.5
2005-06	25,857,661	–

Assessment revenues, which are shown in Table E, depend on the number of each type of provider participating in the Fund and the assessment rates in effect for each provider type. The Board of Governors authorized changes in assessment rates as follows: a 25.0 percent increase in FY 2006-07, a 5.0 percent increase in FY 2007-08, and no change in FY 2008-09. Total assessments can fluctuate at a rate somewhat different than the rate change because of changes in the number and classification of providers.

Table E

Assessment Revenues

Fiscal Year	Assessment Revenues	Change from Prior Year
2008-09	$26,184,712	2.9%
2007-08	25,442,565	5.7
2006-07	24,074,232	27.2
2005-06	18,930,808	–

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 can be seen in Table F, as of June 30, 2009, the vast majority of Fund participants were physicians.

Table F

Providers by Type as of June 30, 2009

Provider Type	Number of Providers	Percentage of Total Providers
Physicians	11,293	84.1%
Corporations	1,327	9.9
Nurse Anesthetists	577	4.3
Hospitals	113	0.8
Partnerships	35	0.3
Hospital-affiliated Nursing Homes	26	0.2
Hospital-owned or -controlled Entities	19	0.1
Ambulatory Surgery Centers	40	0.3
Cooperatives	1	0.0
Total	**13,431**	**100.0%**

Investment income, which includes bond interest, stock dividends, and investment gains and losses, is shown in Table G. Investment income increased by $61.3 million in FY 2006-07, decreased by $41.3 million in FY 2007-08, and then decreased again by $32.1 million in FY 2008-09. The Fund consistently earned approximately $32.0 million in interest income from its debt securities each year. In addition, the Fund realized gains of $28.2 million in FY 2006-07 and $72,000 in FY 2007-08, and it realized losses of $13.2 million in FY 2008-09 from the sale of investments. Investment income was further reduced in FY 2008-09 and FY 2007-08 because of the interest the Fund paid on the negative balance in the State Investment Fund account.

Table G

Investment Income[1]

Fiscal Year	Investment Income[1]	Change from Prior Year
2008-09	$ (5,238,593)	(119.5)%
2007-08	26,841,340	(60.6)
2006-07	68,177,032	897.8
2005-06	6,832,841	–

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

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. Changes in unrealized gains and losses were the result of 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.

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	Change from Prior Year
2008-09	$ (61,115,954)	(145.0)%
2007-08	135,727,751	139.7
2006-07	56,624,865	1,818.2
2005-06	(3,295,595)	–

The major cause of the significant changes in the underwriting expenses is changes in actuarial projections. These projections are 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 will flow through to the underwriting expenses.

For FY 2008-09, 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.

Other Known Facts

The Wisconsin Medical Society filed a lawsuit against the State of Wisconsin regarding the $200.0 million transfer made to the Medical Assistance Trust Fund pursuant to 2007 Wisconsin Act 20. The lawsuit was dismissed in December 2008 and is currently on appeal with the Wisconsin Supreme Court.

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. The Board increased assessment rates by 9.9 percent for FY 2009-10 to begin to address its negative net asset balance but did not factor in the effect of the $200.0 million transfer on the Fund in deciding assessment rates.

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

■ ■ ■ ■

Financial Statements ■

Statement of Net Assets
June 30, 2009, 2008, and 2007

	June 30, 2009	June 30, 2008	June 30, 2007
ASSETS			
Current Assets:			
Cash and cash equivalents (Note 3A)	$ 0	$ 0	$ 41,206,981
Investments (Note 3B)	65,930,462	74,473,775	34,250,035
Investment income receivable	9,208,849	9,792,789	9,630,479
Assessments receivable	76,117	82,444	155,949
Other receivables	22,757	29,465	15,852
Supplies inventory and other assets	9,390	8,026	8,824
Total Current Assets	75,247,575	84,386,499	85,268,120
Noncurrent Assets:			
Investments (Note 3B)	569,901,068	686,685,486	713,220,491
Total Noncurrent Assets	569,901,068	686,685,486	713,220,491
TOTAL ASSETS	**645,148,643**	**771,071,985**	**798,488,611**
LIABILITIES			
Current Liabilities:			
Loss liabilities—current portion	84,275,655	108,676,661	58,852,000
Due to the State Investment Fund (Note 4)	76,831,399	35,337,940	0
Assessments received in advance (Note 2E)	1,385,595	3,591	1,406,544
Provider refunds payable	325,167	227,436	299,343
General and administrative expense payable	94,241	470,344	315,803
Medical mediation panel fees payable (Note 8)	19,431	4,128	18,647
Compensated absences (Note 2J)	10,888	9,876	14,377
Total Current Liabilities	162,942,376	144,729,976	60,906,714
Noncurrent Liabilities:			
Loss liabilities (Note 5):			
Loss liability for incurred but not reported losses	629,545,860	738,591,094	713,963,224
Loss liability for reported losses	33,040,212	49,633,822	49,119,151
Loss liability for loss adjustment expense	124,896,628	164,922,511	156,788,899
Estimated loss liabilities	787,482,700	953,147,427	919,871,274
Amount representing interest	(148,046,748)	(181,098,011)	(226,799,649)
Discounted loss liabilities	639,435,952	772,049,416	693,071,625
Liabilities for future medical expense (Note 6)	34,970,448	23,415,191	6,927,070
Contributions being held liability (Note 7)	1,000,000	1,000,000	2,000,000
Total loss liabilities	675,406,400	796,464,607	701,998,695
Less: loss liabilities—current portion	(84,275,655)	(108,676,661)	(58,852,000)
Noncurrent loss liabilities	591,130,745	687,787,946	643,146,695
Compensated absences (Note 2J)	33,526	30,167	26,677
Other postemployment benefits (Note 11)	24,090	13,556	0
Total Noncurrent Liabilities	591,188,361	687,831,669	643,173,372
TOTAL LIABILITIES	**754,130,737**	**832,561,645**	**704,080,086**
NET ASSETS			
Net Assets (Note 2I):			
Restricted for injured patients and families	0	0	94,408,525
Unrestricted	(108,982,094)	(61,489,660)	0
TOTAL NET ASSETS	**$ (108,982,094)**	**$ (61,489,660)**	**$ 94,408,525**

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, 2009, 2008, and 2007

	Year Ended June 30, 2009	Year Ended June 30, 2008	Year Ended June 30, 2007
OPERATING REVENUES			
Assessments (Note 2E)	$ 26,184,712	$ 25,442,565	$ 24,074,232
Assessment Interest Income (Note 9)	130,247	204,748	143,988
Assessment Administrative Fee Income	36,050	43,119	43,389
Total Operating Revenues	**26,351,009**	**25,690,432**	**24,261,609**
OPERATING EXPENSES			
Underwriting Expenses:			
Net losses paid	53,048,161	34,038,634	35,593,965
Loss adjustment expenses paid	5,362,789	5,710,751	4,611,916
Risk management expenses	104,541	85,911	151,631
Medical expenses paid	1,426,762	426,543	236,143
Change in liability for incurred but not reported losses	(109,045,234)	24,627,870	45,730,852
Change in liability for reported losses	(16,593,610)	514,671	(31,086,696)
Change in liability for loss adjustment expense	(40,025,883)	8,133,612	3,651,853
Change in amount representing interest	33,051,263	45,701,638	(3,657,254)
Change in liability for future medical expense	11,555,257	16,488,121	1,392,455
Total Underwriting Expenses	(61,115,954)	135,727,751	56,624,865
General and Administrative Expenses	1,216,520	1,189,940	1,241,758
Total Operating Expenses	**(59,899,434)**	**136,917,691**	**57,866,623**
OPERATING INCOME (LOSS)	**86,250,443**	**(111,227,259)**	**(33,605,014)**
NONOPERATING REVENUES (EXPENSES) AND OPERATING TRANSFERS			
Investment Income	(3,545,599)	27,667,671	68,177,032
Interest Expense	(1,692,994)	(826,331)	0
Miscellaneous Revenue (Expense)	8,756	0	(1,382)
Net Income Before Transfers	81,020,606	(84,385,919)	34,570,636
Operating Transfers:			
Transfers to the Medical Assistance Trust Fund (Note 12)	(128,500,000)	(71,500,000)	0
Transfers to the General Fund (Note 13)	(13,040)	(12,266)	(10,123)
CHANGE IN NET ASSETS	**(47,492,434)**	**(155,898,185)**	**34,560,513**
NET ASSETS			
Net Assets—Beginning of the Year	(61,489,660)	94,408,525	59,848,012
Net Assets—End of the Year	$ (108,982,094)	$ (61,489,660)	$ 94,408,525

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2009, 2008, and 2007

	Year Ended June 30, 2009	Year Ended June 30, 2008	Year Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Received from Providers for Assessments	$ 28,076,818	$ 24,583,655	$ 24,664,970
Cash Received from Primary Malpractice Insurers	0	32,220	4,000,000
Cash Received from Other Sources	421,984	430,634	484,619
Cash Paid for Losses	(53,051,277)	(35,070,854)	(38,593,965)
Cash Paid for Loss Adjustment Expenses	(5,362,789)	(5,710,751)	(4,611,916)
Cash Paid for Future Medical Expenses	(1,426,762)	(426,543)	(236,143)
Cash Paid for Other Expenses	(1,669,882)	(1,129,050)	(1,186,525)
Cash Paid to Providers for Refunds of Fund Fees	(406,053)	(548,519)	(389,292)
Cash Paid for Medical Mediation Panel Fees	(232,832)	(197,884)	(306,214)
Net Cash Provided by (Used for) Operating Activities	**(33,650,793)**	**(18,037,092)**	**(16,174,466)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Change in Loan from the State Investment Fund	41,530,910	35,273,820	0
Interest Payments for State Investment Fund Loan	(1,730,657)	(761,999)	0
Transfers to the Medical Assistance Trust Fund	(128,500,000)	(71,500,000)	0
Transfers to the General Fund	(13,040)	(12,266)	(10,123)
Net Cash Provided by (Used for) Noncapital Financing Activities	**(88,712,787)**	**(37,000,445)**	**(10,123)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest Received	33,973,220	36,113,451	32,957,474
Cash Received as Proceeds from Sales of Investments	95,698,857	38,276,092	208,341,684
Cash Paid for Purchase of Investment Securities	(7,308,497)	(60,558,987)	(197,811,322)
Net Cash Provided by (Used for) Investment Activities	**122,363,580**	**13,830,556**	**43,487,836**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**0**	**(41,206,981)**	**27,303,247**
Cash and Cash Equivalents—Beginning of the Year	0	41,206,981	13,903,734
Cash and Cash Equivalents—End of the Year	$ 0	$ 0	$ 41,206,981
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES			
Operating Income	$ 86,250,443	$ (111,227,259)	$ (33,605,014)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Miscellaneous nonoperating income	8,755	0	(1,382)
Changes in assets and liabilities:			
Decrease (Increase) in assessments receivable	6,327	73,505	(111,348)
Decrease (Increase) in other receivables	6,708	(13,613)	(2,599)
Decrease (Increase) in supplies inventory and other assets	(1,364)	798	1,223
Increase (Decrease) in loss liabilities	(121,058,207)	94,465,911	17,031,209
Increase (Decrease) in other liabilities	1,136,545	(1,336,434)	513,445
Total Adjustments	(119,901,236)	93,190,167	17,430,548
Net Cash Provided by (Used for) Operating Activities	**$ (33,650,793)**	**$ (18,037,092)**	**$ (16,174,466)**
Noncash Activities:			
Net change in unrealized gains (losses)	$ (22,100,236)	$ (7,866,927)	$ 7,265,333
Amortization of bond discounts	(872,916)	(752,647)	(953,870)

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 2008-09, FY 2007-08, and FY 2006-07, 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 change in future years are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 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. The State Investment Fund is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees. Shares in the State Investment Fund are purchased in $1,000 increments, and any remaining cash balance is deposited in the State's bank.

D. Investment Valuation

Investments of the Fund consist of fixed-income securities managed by the State of Wisconsin Investment Board, and shares in equity index funds. All investments 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 office furniture and equipment with a useful life of two or more years and a purchase price of $5,000 or more. Capital assets are depreciated under the straight-line method over the estimated useful lives of the assets. The Fund had disposed of all of the assets it had classified as capital assets prior to June 30, 2007, so there are no capital assets reflected on the accompanying financial statements.

I. Net Assets

Section 655.27(6), Wis. Stats., requires the net proceeds of 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. The net proceeds available for future claim payments totaled $94,408,525 as of June 30, 2007, and were restricted. The Fund's liabilities that related to future claim payments exceeded its assets beginning on June 30, 2008. The Fund's unrestricted net assets were -$108,982,094 as of June 30, 2009, and -$61,489,660 as of June 30, 2008.

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. Unused, earned compensated absences, other than accumulated sick leave, are accrued with a resulting liability. The liability and the expense for compensated absences are based on current rates of pay. The related employer's share of social security taxes, Medicare taxes, and contributions to the Wisconsin Retirement System is also accrued with a resulting liability. The compensated absences liability is classified as either a short-term or a long-term liability based upon an estimate determined by management. The long-term liability portion of the compensated absences liability generally is not paid out until retirement.

3. DEPOSITS AND INVESTMENTS

A. Deposits

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

	June 30, 2009	June 30, 2008	June 30, 2007
Cash and Cash Equivalents:			
Deposits in the State's Bank	$ 0	$ 0	$ 248,981
State Investment Fund Shares	0	0	40,958,000
Total Cash and Cash Equivalents	$ 0	$ 0	$41,206,981

The State Investment Fund is not registered with the Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported at fair value as of June 30. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), (bd), and (dg), Wis. Stats., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposits issued by banks in the United States and solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

Custodial credit risk for deposits is the risk that, 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 risk. Shares in the State Investment Fund are not required to be categorized under GASB Statement 40. For the remaining deposits in the State's bank, all of the deposits that are held in financial institutions are insured up to $100,000 ($250,000 from October 3, 2008, through December 31, 2013) by the Federal Deposit Insurance Corporation, and the State of Wisconsin Public Deposit Guarantee fund insures up to $400,000 above the amount of federal insurance. None of the Fund's June 30 balances were above $500,000, and therefore none would be considered uninsured and uncollateralized.

B. Investments

The Fund's investments are managed by the State of Wisconsin Investment Board, whose objective is to maintain a portfolio of investments with maturities and liquidity levels that are appropriate for 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 approves a statement of investment policy, in which it can provide more specific investment guidelines. These guidelines limit equity investments to 20.0 percent of the Fund's total portfolio.

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

	June 30, 2009	June 30, 2008	June 30, 2007
Fixed-Income:			
U.S. Government and Agency	$221,293,804	$269,168,089	$242,016,761
Industrial	202,050,181	216,332,800	222,422,055
Transportation	11,397,673	14,619,939	14,652,737
Finance	57,544,980	78,972,783	74,301,598
Utilities	49,556,174	48,609,057	46,696,818
Sovereign	5,279,005	11,694,779	9,802,723
Subtotal	$547,121,817	$639,397,447	$609,892,692
Equities:			
Russell 2000 Index Fund	5,962,905	5,882,392	6,997,809
S & P 500 Index Fund	62,810,148	77,605,498	89,080,278
S & P 400 Index Fund	5,692,979	19,239,049	20,706,530
MSCI World Ex-US Index Fund	14,243,681	19,034,875	20,793,217
Subtotal	88,709,713	121,761,814	137,577,834
Total Investments	$635,831,530	$761,159,261	$747,470,526

The Investment Board recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. The Investment Board monitors risk through multiple forms of analysis and reporting. Inspection of level of diversification, nominal risk exposures, risk/return plots, and matching liabilities with assets forms the core of the monitoring process. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines. On a quarterly basis, guideline exceptions, when identified, are reviewed by the Investment Board's Compliance Committee.

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/A1-" or better, using the lower of split rating. As of June 30, these credit ratings were as follows:

	June 30, 2009		June 30, 2008		June 30, 2007	
	Fair value	Percentage	Fair value	Percentage	Fair Value	Percentage
Credit Rating:						
AAA	$230,492,952	42.1%	$293,493,277	45.9%	$268,855,215	41.2%
AA	37,846,917	6.9	52,698,978	8.2	78,019,310	12.0
A	162,840,930	29.8	157,703,044	24.7	155,898,310	24.0
BBB	93,966,506	17.2	108,893,873	17.0	84,937,907	13.1
BB	19,172,012	3.5	16,660,625	2.6	9,931,950	1.5
B	2,800,000	0.5	4,747,650	0.8	4,350,000	0.7
C or Lower	0	0.0	5,200,000	0.8	7,900,000	1.2
Not rated	2,500	0.0	0	0.0	0	0.0
Subtotal	547,121,817	100.0	639,397,447	100.0	609,892,692	93.7
State Investment Fund[1]	0	0.0	0	0.0	40,958,000	6.3
Total	$547,121,817	100.0%	$639,397,447	100.0%	$650,850,692	100.0%

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

Custodial Credit Risk—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, 2009, June 30, 2008, and June 30, 2007, the Fund did not have any investment securities exposed to custodial credit risk.

Concentration of Credit Risk—Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The Fund's investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or sector exposure limits. The guidelines provide that no single issuer may exceed 5.0 percent of the Fund's investments, with the exception of the United States government and its agencies, which may be unlimited. As of June 30, 2009, June 30, 2008, and June 30, 2007, the Fund did not have more than 5.0 percent of its total investments in a single issuer.

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

	June 30, 2009		June 30, 2008		June 30, 2007	
	Fair value	Duration (In Years)	Fair value	Duration (In Years)	Fair Value	Duration (In Years)
Type of Security:						
Government/Agency	$221,293,804	4.68	$269,168,089	4.41	$242,016,761	4.48
Corporate	325,828,013	5.02	370,229,358	5.17	367,875,931	5.79
Subtotal	547,121,817	4.88	639,397,447	4.85	609,892,692	5.27
State Investment Fund[1]	0		0		40,958,000	0.10
Total	$547,121,817	4.88	$639,397,447	4.85	$650,850,692	4.95

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

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2009, June 30, 2008, and June 30, 2007, the Fund did not own any issues denominated in a foreign currency.

4. DUE TO THE STATE INVESTMENT FUND

The Fund had cash overdrafts in the State Investment Fund of $76,831,399 as of June 30, 2009, and $35,337,940 as of June 30, 2008. The cash overdrafts are covered by a temporary loan from other funds in the State Investment Fund and are shown as a liability. The Fund incurred interest expenses of $1,692,994 in FY 2008-09 and $826,331 in FY 2007-08 for this temporary loan.

5. ULTIMATE AND DISCOUNTED LOSS LIABILITIES

A. 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, 2009	June 30, 2008	June 30, 2007
Projected Ultimate Loss Liability	$1,428,828,900	$1,488,727,875	$1,412,981,701
Less:			
Net Losses Paid from Inception	(766,242,828)	(700,502,959)	(649,899,326)
Liability for Reported Losses	(33,040,212)	(49,633,822)	(49,119,151)
Liability for IBNR Losses	$ 629,545,860	$ 738,591,094	$ 713,963,224

The Fund implemented an explicit risk margin in its loss liabilities estimates beginning in FY 2005-06. Previously, the Fund's actuary included an implicit risk margin of approximately 33.0 percent in its estimate of total loss liabilities. In response to a recommendation from an actuarial audit completed in July 2005, the Fund's consulting actuary developed a best estimate of the loss liabilities, and the Board of Governors approved the addition of an explicit 5.0 percent risk margin to the best estimate for June 30, 2007, and an explicit 25.0 percent risk margin to the best estimate for June 30, 2008, and June 30, 2009. The Board decided that it was prudent to increase the explicit risk margin to ensure that the loss liability estimates will 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 20.0 percent of the estimated unpaid loss liabilities as of June 30, 2007, and June 30, 2008, and 18.0 percent as of June 30, 2009. 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, 2009	June 30, 2008	June 30, 2007
Projected Ultimate LAE Liability	$190,159,611	$224,822,705	$210,978,342
Less:			
Net LAE Paid from Inception	(65,262,983)	(59,900,194)	(54,189,443)
Liability for LAE	$124,896,628	$164,922,511	$156,788,899

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 factor, which is based on an investment yield assumption of 5.5 percent approved by the Board of Governors for all three years, was 0.812 for FY 2008-09, 0.810 for FY 2007-08, and 0.753 for FY 2006-07.

D. Loss Liabilities Balances and Activities

	July 1	Additions	Deductions	June 30	Current Portion
FY 2008-09	$796,464,607	$104,447,348	$(225,505,555)	$675,406,400	$ 84,275,655
FY 2007-08	701,998,695	135,641,840	(41,175,928)	796,464,607	108,676,661
FY 2006-07	684,967,487	92,217,183	(75,185,975)	701,998,695	58,852,000

6. Future Medical Expense Liability

Section 655.015, Wis. Stats., requires accounts to be established if a settlement or judgment provides for future medical expense payments in excess of $100,000. 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.

7. 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.

8. Medical Mediation Panel

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 collected $232,832 in fees in FY 2008-09, $197,884 in FY 2007-08, and $306,214 in FY 2006-07.

9. Assessment Interest Income

Fund participants choosing payment plans other than annual are assessed interest on the deferred assessment amounts. Section Ins. 17.28(4), Wis. Adm. Code, prescribes that the daily interest rate to be assessed on the deferred assessments shall be the average annualized rate earned by the Fund on its funds in the State Investment Fund for the first three quarters of the preceding fiscal year, as determined by the State of Wisconsin Investment Board, divided by 360. Interest was assessed at the rate of 4.435 percent for FY 2008-09, 5.275 percent for FY 2007-08, and 3.924 percent for FY 2006-07.

10. 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 $100,264 in annuity payments through June 30, 2009, 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 $224, and additional lump-sum payments due every five years through 2025, to cover defaulted payments. The Fund has received reimbursement for these payments, including interest of $92,797 through June 30, 2009. 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 as of June 30, 2009, 2008, and 2007, was $32.8 million, $32.8 million, and $161.8 million, respectively. Beginning with the June 30, 2008 replacement value calculation, only annuities of which the Fund remains the owner are included. Annuities with qualified assignments are not included.

11. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

As permanent full-time employees of the State of Wisconsin, employees of the Injured Patients and Families Compensation Fund are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee's classifications, plus employer contributions at a rate determined annually. Both employee and employer contributions are included as part of general and administrative expenses each year. The Injured Patients and Families Compensation Fund's contributions to the plan were $54,659 for FY 2008-09, $53,835 for FY 2007-08, and $52,880 for FY 2006-07. The relative position of the Injured Patients and Families Compensation Fund in the Wisconsin Retirement System is not available because the Wisconsin Retirement System is a statewide, multiple-employer plan.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for FY 2007-08. In accordance with the provisions on GASB Statement No. 45, the State is required to report other postemployment benefit (OPEB) expenses and related liabilities in its financial statements and notes. Since this statement was not adopted early, only the FY 2007-08 and FY 2008-09 financial statements include the Fund's portion of the State's OPEB expense as part of general and administrative expenses and the related liabilities. The State's OPEBs include an implicit subsidy of retiree health insurance present in the contribution rates for existing employees under the State's health insurance program, and post-employment coverage in the State's life insurance program.

Copies of the separately issued financial reports for the Wisconsin Retirement System and the life insurance program may be obtained by writing to:

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

The most current financial report is also available on the Department of Employee Trust Funds' Web site, *www.etf.wi.gov*. The disclosures for the health insurance plan are included in the State's Comprehensive Annual Financial Report. That report is publicly available at *www.doa.state.wi.us* or may be obtained by writing to:

State Controller's Office
Department of Administration
101 East Wilson Street
Madison, Wisconsin 53702

12. TRANSFERS OUT TO THE MEDICAL ASSISTANCE TRUST FUND

Section 9225(2) of 2007 Wisconsin Act 20 required the Injured Patients and Families Compensation Fund to transfer $128.5 million in FY 2008-09 and $71.5 million in FY 2007-08 to the Medical Assistance Trust Fund. The Wisconsin Medical Society has filed a lawsuit on behalf of its members challenging the transfer as unconstitutional. The lawsuit was dismissed in December 2008 and is currently on appeal with the Wisconsin Supreme Court.

13. 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 79 of 2005 Wisconsin Act 25 required state agencies to make certain transfers to the General Fund for its related unfunded retirement liability debt service payments.

14. 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.

■ ■ ■ ■

Report on Control and Compliance ▪

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

We have audited the financial statements of the Wisconsin Injured Patients and Families Compensation Fund as of and for the years ended June 30, 2009, 2008, and 2007, and have issued our report thereon dated March 15, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the Fund's internal control over financial reporting (internal control) as a basis for designing our auditing 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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent 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 Fund's financial statements will not be prevented or will not be detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph. However, we consider deficiencies with the Fund's provider system and the lack of sufficient procedures and controls to ensure that the Fund's cash flow statements are properly presented to be significant deficiencies. 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.

As further discussed in the audit report section titled "Provider System," the aging and decreasing effectiveness of the Fund's provider system resulted in regularly occurring errors that required manual adjustment. The occurrence of the errors and the need to manually identify and correct them increased the risks associated with the financial statements. In response, the Office of the Commissioner of Insurance implemented a new system in March 2010.

We identified errors in the Fund's FY 2006-07 and FY 2008-09 cash flow statements pertaining to the cash flows of the Fund's investment activities. Both investment sales and purchases were understated in FY 2006-07 by $69.6 million, and investment sales were overstated and interest income was understated in FY 2008-09 by $4.3 million in the investing activities section of the Statement of Cash Flows.

During our audits, we discussed proper reporting of investment activity with the Fund's staff and encouraged them to consult with the State of Wisconsin Investment Board, which manages the Fund's investments, to ensure appropriate information and interpretation of investment-related activities are reported in the Fund's financial statements. The Fund's staff corrected the misstatements and provided revised financial statements. The Fund's management agrees with the recommendation to improve the reporting process on the investment activities and has developed written procedures to assist in its completion of the investment activities portion of the Statement of Cash Flows.

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 responses of the Office of the Commissioner of Insurance to the findings identified in our audit are described in the preceding paragraphs. We did not audit the responses and, accordingly, express no opinion on them.

As part of our separate audit of the Wisconsin State Life Insurance Fund audit, we noted certain additional matters pertaining to access to the computer storage room and off-site storage locations for the Office of the Commissioner of Insurance that had an effect on the Injured Patients and Families Compensation Fund. These issues were reported to management of the Office of the Commissioner of Insurance in a separate letter dated December 3, 2009.

This independent auditor's report is intended solely for the information and use of the Wisconsin Injured Patients and Families Compensation Fund's management, 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

March 15, 2010 by Diann Allsen

Diann Allsen
Audit Director

Appendix 1

Annual Provider Assessments[1]

Provider Types	Fiscal Year 2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Physician Class 1[2]	$1,461	$1,534	$1,227	$ 859	$1,074	$1,128	$1,128	$1,240
Physician Class 2[3]	2,630	2,761	2,209	1,546	1,933	2,030	2,030	2,231
Physician Class 3[4]	6,063	6,366	5,092	3,565	4,457	4,681	4,681	5,144
Physician Class 4[5]	8,766	9,204	7,362	5,154	6,444	6,768	6,768	7,438
Nurse Anesthetist	359	377	302	211	264	277	277	304
Hospital—per Occupied Bed	88	92	74	52	65	68	68	75
Nursing Home—per Occupied Bed	16	17	14	10	13	14	14	15
Employees of a Partnership or Corporation:								
Nurse Practitioner	365	384	307	215	269	282	282	310
Advanced Nurse Practitioner	511	537	429	301	376	395	395	434
Nurse Midwife	3,214	3,375	2,699	1,890	2,363	2,482	2,482	2,728
Advanced Nurse Midwife	3,360	3,528	2,822	1,976	2,470	2,594	2,594	2,851
Advanced Practice Nurse Prescriber	511	537	429	301	376	395	395	434
Chiropractor	584	614	491	344	430	451	451	496
Dentist	292	307	245	172	215	226	226	248
Oral Surgeon	2,192	2,301	1,841	1,289	1,611	1,692	1,692	1,860
Podiatrists—Surgical	6,209	6,520	5,215	3,651	4,565	4,794	4,794	5,269
Optometrist	292	307	245	172	215	226	226	248
Physician Assistant	292	307	245	172	215	226	226	248

[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.

Appendix 2

Claim Payments of $5 Million or More through December 31, 2009

Amount (in millions)[1]	Calendar Year of Incident	Calendar Year of Payment	Claimant Allegations
$34.3	2004	2008	Negligent blood transfusion caused cardiac arrest and brain damage
18.0	1986	1990	Diet pills prescribed without a complete physical evaluation caused cardiac arrest and brain damage
16.1	2007	2009	Improperly performed surgical procedure caused brain damage
15.6	1993	1996	Negligent treatment caused quadriplegia
13.6	1993	2000	Initial surgery and follow-up treatment of pinched nerve were negligent, which caused continuing pain
11.0	2003	2007	Negligent delivery caused brain damage
10.1	1997	2005	Negligent treatment caused brain damage
10.0	2002	2006	Negligent labor and delivery of twins caused brain damage
9.6	1998	2001	Negligent prescriptions caused brain damage
9.5	1989	1990	Improperly administered anesthesia caused brain damage during cardiac surgery
9.4	2005	2008	Negligent labor and delivery caused brain damage
9.1	2000	2007	Negligent surgery resulted in the inability to eat or drink
8.8	2000	2006	Negligent labor and delivery caused brain damage
8.7	1988	1999	Negligent treatment caused brain damage, and lack of informed consent
8.6	2006	2008	Failure to properly inject medication caused brain damage
7.9	1985	1995	Failure to diagnose a hematoma caused brain damage, and lack of informed consent
7.3	1987	1992	Failure to identify high bilirubin level in a timely manner caused brain damage
7.2	2001	2004	Failure to diagnose Strep A
7.1	1990	1995	Failure to promptly deliver baby caused cerebral palsy
6.9	1992	2000	Negligent delivery caused brain damage
6.8	1992	1995	Negligent treatment of brain aneurysm
6.8	1999	2006	Negligent labor and delivery caused brain damage
6.6	1992	2001	Failure to diagnose blood disorder in infant caused brain damage
6.6	1997	2008	Negligent labor and delivery caused brain damage
6.0	1999	2002	Negligent delivery caused brain damage
5.9	1999	2002	Failure to restrain patient during psychiatric care caused quadriplegia
5.8	1990	1996	Surgery caused brain injury, and lack of informed consent
5.6	1995	1998	Negligent treatment caused brain damage
5.6	1993	1999	Negligent treatment caused brain damage
5.1	1982	1984	Failure to diagnose and treat meningitis
5.0	2004	2008	Negligent delivery caused brain damage
5.0	2003	2009	Negligent labor and delivery caused cerebral palsy
5.0	2005	2009	Negligent surgeries resulted in the inability to walk, speak, or swallow

[1] Includes interest on losses paid.

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Sean Dilweg, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: ociinformation@wisconsin.gov
Web Address: oci.wi.gov

March 15, 2010

JANICE MUELLER STATE AUDITOR
LEGISLATIVE AUDIT BUREAU
22 EAST MIFFLIN STREET SUITE 500
MADISON WI 53703

Dear Ms. Mueller:

We are in receipt of the Legislative Audit Bureau's draft audit report of the Injured Patients and Families Compensation Fund and would like to respond to the following recommendations:

"Our recommendation again addresses the need for the Fund's Board of Governors to require the next actuarial audit to evaluate the appropriateness of the Fund's explicit loss liability risk margin and its investment return assumption, and convey that information in its annual report to the Legislature."

The Fund's Board of Governors passed a motion which will require such an audit to be conducted at least once every three years. An actuarial audit was completed in 2008 and another audit will be conducted on the actuarial work performed as of September 30, 2010. The prior actuarial audit did not address the risk margin nor the investment return assumption as neither of these were determined by the Fund's contract actuary, but rather were established by the Fund's Board and Committee. The actuarial audit that will be performed in 2010-2011 will include a review and opinion as to the reasonableness of both the risk margin and investment return assumptions as set by the Board. The results of this actuarial audit will be reported to the Legislature in the Fund's annual Functional and Progress Report to the Legislature.

Sincerely,

Eileen K Mallow

Eileen Mallow
Assistant Deputy Commissioner
Office of the Commissioner of Insurance