

# Risk Management Fund



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT  
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Members of the General Assembly  
Members of the Board of Claims  
The Honorable David H. Lillard, Jr., Treasurer

## Report on the Financial Statements

We have audited the accompanying statement of net position of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2017, the related statements of revenues, expenses, and changes in fund net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Risk Management Fund's basic financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

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

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the Board of Claims. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Risk Management Fund.

## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Risk Management Fund of the State of Tennessee as of June 30, 2017, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Emphasis of Matter***

As discussed in Note A.1., the financial statements present only the Risk Management Fund, an internal service fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2017, and the changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2017, on our consideration of the Risk Management Fund's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Risk Management Fund's internal control over financial reporting and compliance.



Deborah V. Loveless, CPA

Director

December 14, 2017

# Risk Management Fund

## Risk Management Fund Statement of Net Position June 30, 2017

### ASSETS

#### Current assets

Cash	\$	167,038,646
Due from component unit		208,478

#### Total current assets

167,247,124

#### Noncurrent assets

Due from federal government		5,328,013
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### TOTAL ASSETS

172,575,137

### LIABILITIES

#### Current liabilities

Accounts payable		1,503,250
Unearned revenue		1,000
Claims liability		34,782,339

#### Total current liabilities

36,286,589

#### Noncurrent liabilities

Claims liability		113,759,000
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### TOTAL LIABILITIES

150,045,589

### NET POSITION - UNRESTRICTED

\$ 22,529,548

*See accompanying Notes to the Financial Statements*

# Risk Management Fund

## Risk Management Fund Statement of Revenues, Expenses, and Changes in Fund Net Position For Fiscal Year Ended June 30, 2017

### OPERATING REVENUES

Casualty premiums	\$	57,061,922
Property premiums		9,520,742
Return to Work Penalties		18,148
<b>TOTAL OPERATING REVENUES</b>		<b>66,600,812</b>

### OPERATING EXPENSES

Torts		
Death		925,710
Bodily injury		2,090,391
Property damage		1,265,829
Total Torts		4,281,930
Workers' Compensation		
Death		228,607
Medical		13,595,297
Temporary disability		1,220,270
Permanent disability		7,082,309
Total Workers' Compensation		22,126,483
Property Damage		
Employee property		18,386
State owned property		6,198,776
Total Property Damage		6,217,162
Property insurance premiums		5,639,476
Professional/Administrative		10,638,270
Decrease in accrued liability		(1,779,434)
<b>TOTAL OPERATING EXPENSES</b>		<b>47,123,887</b>
<b>OPERATING INCOME</b>		<b>19,476,925</b>
NON-OPERATING REVENUES		
Interest Income		641,696
Taxes		1,424
<b>TOTAL NON-OPERATING REVENUES</b>		<b>643,120</b>
<b>CHANGE IN NET POSITION</b>		<b>20,120,045</b>
<b>NET POSITION, BEGINNING OF YEAR</b>		<b>2,409,503</b>
<b>NET POSITION, END OF YEAR</b>	\$	<b>22,529,548</b>

See accompanying Notes to the Financial Statements

# Risk Management Fund

## Risk Management Fund Statement of Cash Flows For Fiscal Year Ended June 30, 2017

### CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from premiums	\$	66,600,812
Receipts from insurance proceeds		6,256,678
Payments for claims		(33,153,180)
Payments for administrative expenses		(10,645,590)
Payments for insurance premiums		(5,639,476)
NET CASH FROM OPERATING ACTIVITIES		<u>23,419,244</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes received		<u>1,423</u>
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES		<u>1,423</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Interest received		<u>641,696</u>
NET CASH FROM INVESTING ACTIVITIES		<u>641,696</u>
NET INCREASE IN CASH		24,062,363
CASH, BEGINNING OF YEAR		<u>142,976,283</u>
CASH, END OF YEAR	\$	<u><u>167,038,646</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME	\$	19,476,925
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
Decrease in accounts receivable		4,791,523
Increase in accounts payable		627,925
Decrease in claims liability		(1,477,129)
TOTAL ADJUSTMENTS		<u>3,942,319</u>
NET CASH FROM OPERATING ACTIVITIES	\$	<u><u>23,419,244</u></u>

# Risk Management Fund

## Risk Management Fund Notes to the Financial Statements June 30, 2017

### A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### 1. Reporting Entity

The Risk Management Fund (RMF) is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an internal service fund.

#### 2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. The RMF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the services provided by the RMF. The principal operating revenue of the RMF consists of charges to its customers for insurance premiums. Operating expenses include claims expenses, insurance premiums, administrative expenses and the current charge to the accrued liability. Revenues and expenses not resulting from the services provided by the RMF are reported as nonoperating revenues and expenses.

#### 3. Cash

The Risk Management Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally recognized ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented in the State Pooled Investment Fund Report.

### B. DEPOSITS AND INVESTMENTS

#### 1. Risk Management

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice liability, and workers' compensation. By statute, the maximum liability for general liability, automobile liability, and medical malpractice liability is \$300,000 per person and \$1 million per occurrence. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the RMF. The state purchases commercial insurance for real property, crime and fidelity coverage on the state's officials and employees and cyber liability coverage. For property coverage, the deductible for an individual state agency is the first \$25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of \$7.5 million for perils other than earthquake and flood. Purchased insurance coverage is responsible for losses exceeding the \$7.5 million annual aggregate deductible. For earthquake and flood, there is a deductible of

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\$10 million per occurrence. The maximum insurance coverage is \$750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is \$50 million per occurrence. Settled claims resulting from these risks have not exceeded maximum commercial insurance coverage in any of the past three fiscal years. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Board and the Certified Cotton Growers' Organization. The Tennessee Education Lottery Corporation participates in the RMF for general liability purposes but is responsible for its own worker's compensation coverage.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

The present value of the casualty liability as actuarially determined was \$140,721,000 (discounted at 1.0%) at June 30, 2017. The accrued liability for incurred property losses was \$6,988,005 at June 30, 2017. The changes in the balances of the claims liabilities during fiscal years 2017 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in		Ending Claims Liability
		Estimates	Claims Payments	
2017	\$150,018,468	37,102,817	(38,579,946)	\$148,541,339

The RMF held \$167 million in cash at June 30, 2017 that is designated for payment of these claims.

The RMF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole.

## 2. Receivable

The receivables shown on the Statement of Net Position as due from federal government include funds to be received from the Federal Emergency Management Agency for property losses that were classified as a disaster.

## 3. Insurance Proceeds

The State receives property insurance proceeds from our commercial insurance carriers in excess of our deductible for losses. Current estimated property losses at June 30, 2017 were \$8,123,005 while estimated proceeds from commercial insurance carriers above our deductible were \$1,135,000 which includes the balance at June 30, 2017 of \$832,334 of insurance proceeds on hand for the payment of claims. This results in a \$6,988,005 liability for property losses to be established at June 30, 2017.