

Risk Management Fund



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

Independent Auditor's Report

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, 2018, 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

Risk Management Fund

used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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, 2018, 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, 2018, 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 13, 2018, 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
Division of State Audit
December 13, 2018

Risk Management Fund

Risk Management Fund Statement of Net Position June 30, 2018

ASSETS

Current assets

Cash	\$	188,874,443
Due from federal government		2,831,414
Total current assets		<u>191,705,857</u>

TOTAL ASSETS		<u>191,705,857</u>
--------------	--	--------------------

LIABILITIES

Current liabilities

Accounts payable		1,207,889
Unearned revenue		1,000
Claims liability		33,950,412
Total current liabilities		<u>35,159,301</u>

Noncurrent liabilities

Claims liability		<u>107,280,000</u>
------------------	--	--------------------

TOTAL LIABILITIES		<u>142,439,301</u>
-------------------	--	--------------------

NET POSITION - UNRESTRICTED	\$	<u>49,266,556</u>
-----------------------------	----	-------------------

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, 2018

OPERATING REVENUES

Casualty premiums	\$	51,941,668
Property premiums		10,994,300
Return to Work Penalties		13,289
TOTAL OPERATING REVENUES		<u>62,949,257</u>

OPERATING EXPENSES

Torts		
Death		1,222,619
Bodily injury		2,748,630
Property damage		1,101,310
Total Torts		<u>5,072,559</u>
Workers' Compensation		
Death		295,777
Medical		12,580,091
Temporary disability		994,391
Permanent disability		5,303,707
Total Workers' Compensation		<u>19,173,966</u>
Property Damage		
Employee property		5,904
State owned property		5,663,255
Total Property Damage		<u>5,669,159</u>
Property insurance premiums		5,633,673
Professional/Administrative		11,124,766
Decrease in accrued liability		(7,393,866)
TOTAL OPERATING EXPENSES		<u>39,280,257</u>
OPERATING INCOME		23,669,000
NON-OPERATING REVENUES		
Grant revenue		889,664
Interest Income		2,177,936
Taxes		408
TOTAL NON-OPERATING REVENUES		<u>3,068,008</u>
CHANGE IN NET POSITION		26,737,008
NET POSITION, BEGINNING OF YEAR		<u>22,529,548</u>
NET POSITION, END OF YEAR	\$	<u>49,266,556</u>

See accompanying Notes to the Financial Statements

Risk Management Fund

Risk Management Fund Statement of Cash Flows For Fiscal Year Ended June 30, 2018

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from premiums	\$	62,949,257
Receipts from insurance proceeds		811,208
Payments for claims		(29,208,129)
Payments for administrative expenses		(10,159,526)
Payments for insurance premiums		(5,625,021)

NET CASH FROM OPERATING ACTIVITIES 18,767,789

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Grant received		889,664
Taxes received		408

NET CASH FROM NONCAPITAL FINANCING ACTIVITIES 890,072

CASH FLOW FROM INVESTING ACTIVITIES

Interest received		2,177,936
-------------------	--	-----------

NET CASH FROM INVESTING ACTIVITIES 2,177,936

NET INCREASE IN CASH 21,835,797

CASH, BEGINNING OF YEAR 167,038,646

CASH, END OF YEAR \$ 188,874,443

RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES

OPERATING INCOME \$ 23,669,000

ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES

Changes in assets and liabilities		
Decrease in accounts receivable		2,705,077
Increase in accounts payable		(295,361)
Decrease in claims liability		(7,310,927)

TOTAL ADJUSTMENTS (4,901,211)

NET CASH FROM OPERATING ACTIVITIES \$ 18,767,789

Risk Management Fund

Risk Management Fund Notes to the Financial Statements For Fiscal Year Ended June 30, 2018

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. OTHER ACCOUNTING DISCLOSURES

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, 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

Risk Management Fund

aggregate deductible. For earthquake and flood, there is a deductible of \$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 \$134,183,000 (discounted at 2.1%) at June 30, 2018. The accrued liability for incurred property losses was \$6,132,139 at June 30, 2018. The changes in the balances of the claims liabilities during fiscal years 2018 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claims Payments	Ending Claims Liability
2018	\$148,541,339	23,333,026	(30,643,953)	\$141,230,412

The RMF held \$189 million in cash at June 30, 2018 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, 2018 were \$8,462,139 while estimated proceeds from commercial insurance carriers above our deductible were \$2,330,000. This results in a \$6,132,139 liability for property losses to be established at June 30, 2018. Additionally we have a balance at June 30, 2018 of \$915,273 of insurance proceeds on hand for the payment of claims.



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

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*

Members of the General Assembly
Members of the Board of Claims
The Honorable David H. Lillard, Jr., Treasurer

We have audited the financial statements of the Risk Management Fund, as of and for the year ended June 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated December 13, 2018. 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.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department of the Treasury's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department'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 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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did

not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Risk Management Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Deborah V. Loveless, CPA, Director
Division of State Audit
December 13, 2018