



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

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, 2019, 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

Risk Management Fund

no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the 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, 2019, 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, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2019, 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. 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, 2019, 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, 2019

Risk Management Fund

Risk Management Fund Statement of Net Position June 30, 2019

ASSETS

Current assets	
Cash	\$ 185,835,351
Due from federal government	328,460
Total current assets	<u>186,163,811</u>
TOTAL ASSETS	<u>186,163,811</u>
LIABILITIES	
Current liabilities	
Accounts payable	823,203
Unearned revenue	1,000
Claims liability	35,013,693
Total current liabilities	<u>35,837,896</u>
Noncurrent liabilities	
Claims liability	109,891,000
Total noncurrent liabilities	<u>109,891,000</u>
TOTAL LIABILITIES	<u>145,728,896</u>
NET POSITION - UNRESTRICTED	<u>\$ 40,434,915</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, 2019

OPERATING REVENUES

Casualty premiums	\$	24,151,000
Property premiums		13,015,300
Return to work penalties		40,840
TOTAL OPERATING REVENUES		37,207,140

OPERATING EXPENSES

Tort Expenses		
Death		678,699
Bodily injury		4,212,524
Property damage		1,315,053
Total Tort Expenses		6,206,276
Workers' Compensation Expenses		
Death		264,984
Medical		11,833,705
Temporary disability		752,046
Permanent disability		3,901,942
Total Workers' Compensation Expenses		16,752,677
Property Damage		
Employee property		13,924
State owned property		5,090,303
Total Property Damage		5,104,227
Property insurance premiums		5,454,097
Professional/Administrative		12,191,377
Change in accrued liability		4,265,190
TOTAL OPERATING EXPENSES		49,973,844
OPERATING LOSS		(12,766,704)
NON-OPERATING REVENUES		
Interest Income		3,934,291
Taxes		772
TOTAL NON-OPERATING REVENUES		3,935,063
CHANGE IN NET POSITION		(8,831,641)
NET POSITION, BEGINNING OF YEAR		49,266,556
NET POSITION, END OF YEAR	\$	40,434,915

See accompanying Notes to the Financial Statements

Risk Management Fund

Risk Management Fund Statement of Cash Flows For Fiscal Year Ended June 30, 2019

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from premiums	\$ 37,207,140
Payments for claims	(26,297,072)
Payments for administrative expenses	(12,421,474)
Payments for insurance premiums	(5,462,749)
NET CASH USED FOR OPERATING ACTIVITIES	<u>(6,974,155)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Taxes received	<u>772</u>
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	772
CASH FLOW FROM INVESTING ACTIVITIES	
Interest received	<u>3,934,291</u>
NET CASH FROM INVESTING ACTIVITIES	3,934,291
NET DECREASE IN CASH	(3,039,092)
CASH, BEGINNING OF YEAR	<u>188,874,443</u>
CASH, END OF YEAR	<u>\$ 185,835,351</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES	
OPERATING LOSS	\$ (12,766,704)
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES	
CHANGES IN ASSETS AND LIABILITIES	
Decrease in accounts receivable	2,502,953
Increase in accounts payable	(384,686)
Decrease in claims liability	3,674,282
TOTAL ADJUSTMENTS	<u>5,792,549</u>
NET CASH USED FOR OPERATING ACTIVITIES	<u>\$ (6,974,155)</u>

See accompanying Notes to the Financial Statements

Risk Management Fund

Risk Management Fund Notes to the Financial Statements For Fiscal Year Ended June 30, 2019

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. That report is available on the state's website at www.tn.gov/finance/rd-doa/fa-accfm-cafr.html.

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. That report is available on the state's website at www.treasury.tn.gov.

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

Risk Management Fund

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 \$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 \$133,692,000 (discounted at 1.5%) at June 30, 2019. The accrued liability for incurred property losses was \$10,888,329 at June 30, 2019. The changes in the balances of the claims liabilities during fiscal year 2019 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in		Ending Claims Liability
		Estimates	Claims Payments	
2019	\$141,230,412	32,328,369	(28,654,088)	\$144,904,693

The RMF held \$186 million in cash at June 30, 2019, 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, 2019, were \$12,130,958 while estimated proceeds from commercial insurance carriers above our deductible were \$1,242,630. This results in a \$10,888,329 liability for property losses to be established at June 30, 2019. Additionally we have a balance at June 30, 2019, of \$324,365 of insurance proceeds on hand for the payment of claims.