



Johnson Lambert
cpas + consultants

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Financial Reporting, Auditing, and Risk Management for Trustees

NLC RISC

May 17, 2019

Board Key Functions over Financial Reporting

Ensuring the integrity of the accounting and financial reporting systems, including:

Reviewing and
approving the
financial statements

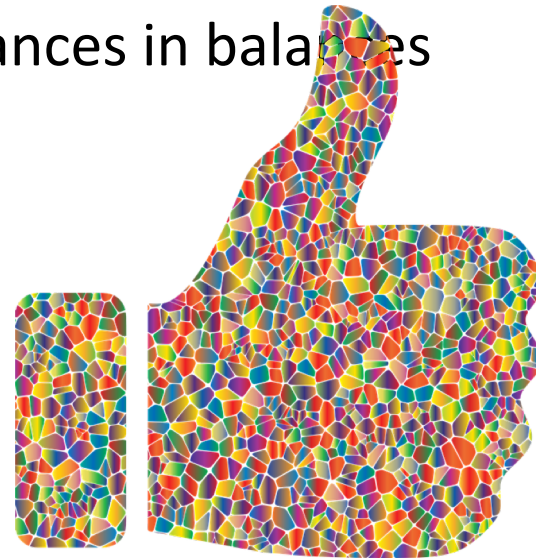
Assuring proper
internal controls are
in place

Selection and
monitoring of
independent auditor

Financial Statements

Financial Statements – Review & Approval

- Review of key audit areas
- Reading financial statements (key is to understand your financial statements)
- Asking questions on variances in balances
- Review ratios
- Making inquiries
 - Potential litigation
 - Compliance issues



Statement of Net Position

Held at fair value

A/R

Case and IBNR reserves

Assets

Investments

Fixed maturity securities, at fair value	\$ 24,000,000	\$ 19,378,000
Mutual funds, at fair value	63,500,000	65,987,000
Investment in XXX Insurance Company	<u>3,200,000</u>	<u>3,010,000</u>
Total investments	90,700,000	88,375,000

Cash and cash equivalents	1,832,000	3,263,000
Reinsurance recoverable on paid losses	2,069,000	28,000
Member receivables, net of allowance for doubtful accounts	12,196,000	10,381,000
Interest receivable	43,000	112,000
Prepaid expenses and other assets	200,000	312,000
Fixed assets, net of accumulated depreciation	153,000	157,000
Deposit held	<u>7,200</u>	<u>8,000</u>

Total Assets	<u>\$ 107,200,200</u>	<u>\$ 102,636,000</u>
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Liabilities and Net Position

Liabilities

Unpaid losses and loss adjustment expenses, net of reinsurance	\$ 48,900,000	\$ 56,222,600
Claims payable	3,250,000	2,750,000
Members payable	500,000	1,500,000
Accounts payable and accrued expenses	<u>2,150,200</u>	<u>2,008,500</u>
Total Liabilities	54,800,200	62,481,100

Net Position

Unrestricted net position	<u>52,400,000</u>	<u>40,154,900</u>
Total Liabilities and Net Position	<u>\$ 107,200,200</u>	<u>\$ 102,636,000</u>



Statements of Operations and Changes in Net Position

Member
contributions

Operating Revenues

Premiums written and earned, net of reinsurance	\$ 75,150,000	\$ 74,500,000
Miscellaneous income	170,000	125,000
Total operating revenues	75,320,000	74,625,000

Loss paid &
Change in loss
reserves

Operating Expenses

Incurred losses and loss adjustment expenses, net of reinsurance	60,189,600	66,588,000
General and administrative expenses	4,555,500	5,150,850
Total operating expenses	64,745,100	71,738,850
Operating income	10,574,900	2,886,150

Investment income

Non-Operating Revenues

Net investment income	980,150	637,000
Net (decrease) increase in fair value of investments	(310,000)	1,582,000
Net realized gains on sale of investments	1,500,850	49,250

Net non-operating revenues	2,171,000	2,268,250
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Change in Net Position	12,745,900	5,154,400
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Net Position, Beginning of Year	40,154,900	35,000,500
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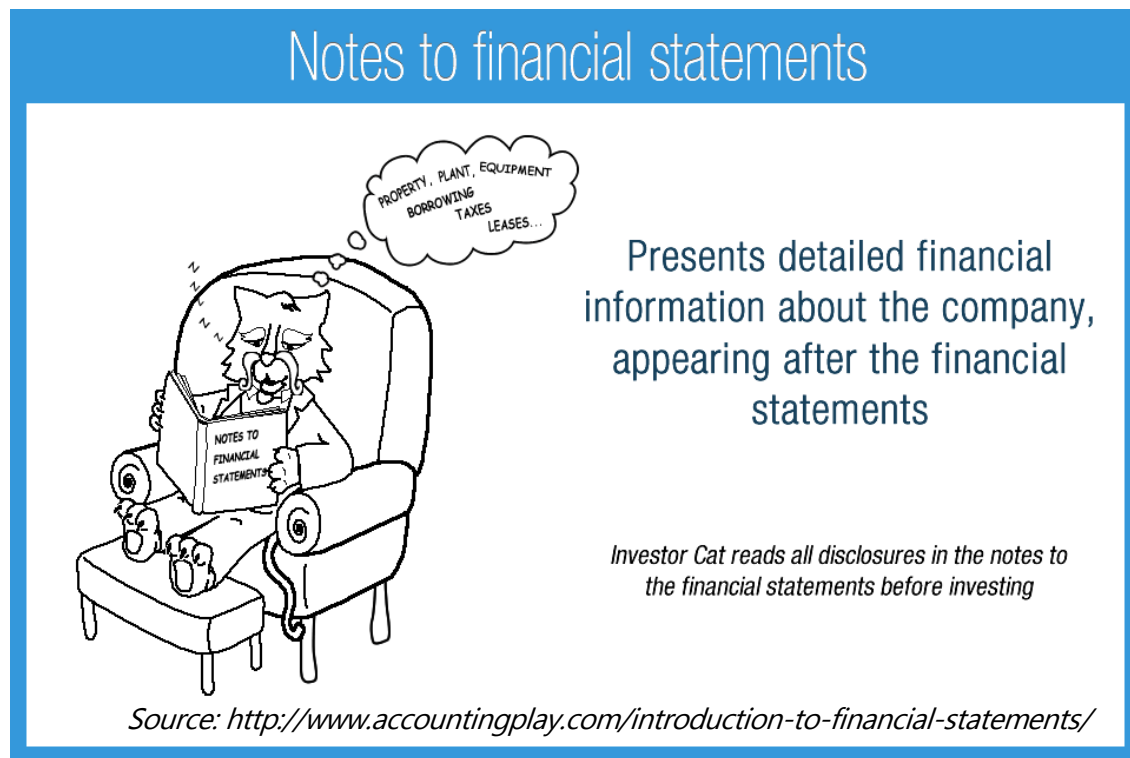
Earned Equity Distribution	(500,800)	-
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Net Position, End of Year	\$ 52,400,000	\$ 40,154,900
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Notes to the Financial Statements

- Accounting policies
- Business plan
- Operations
- Related parties



Key Audit Areas:

+ Investments

+ Claims

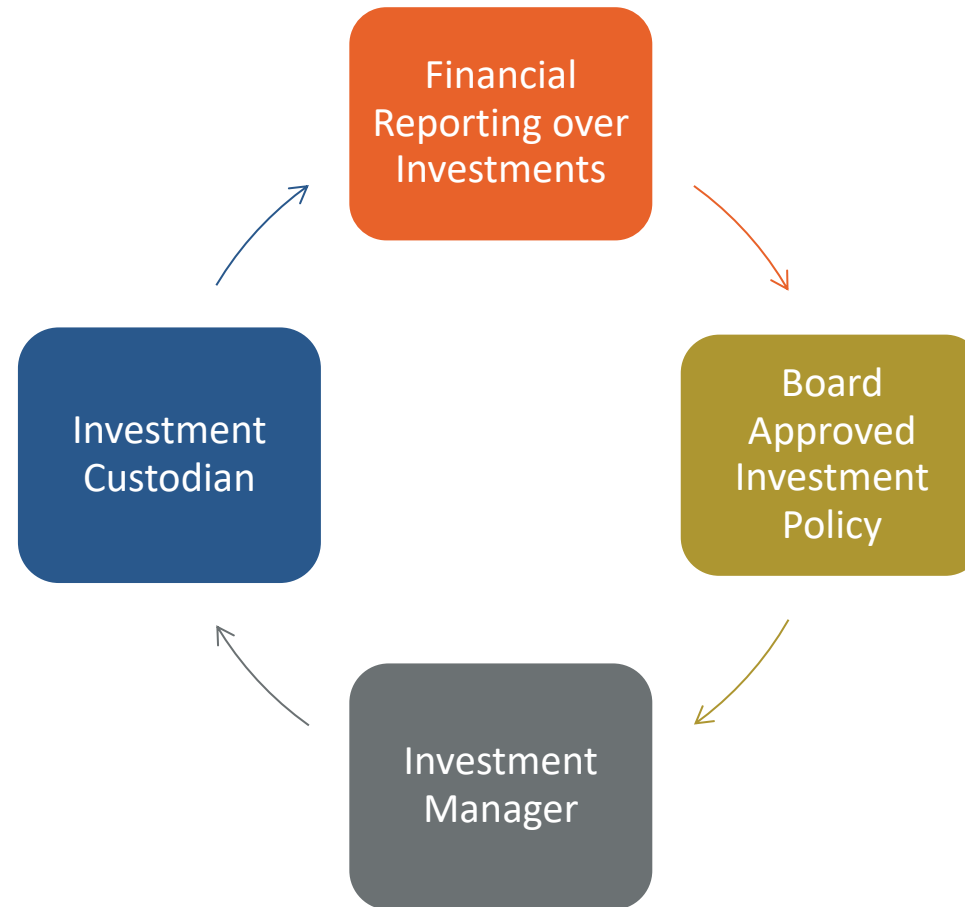
+ Underwriting

+ Reinsurance

+ Equity

Investments

Investment Cycle



Investment – Board's Questions

Why do we take so much risk on our investments?

Why are we not following our investment policy?

Why does our investment manager not present to the Board?



Investment Ratings

	U.S. Treasuries	U.S. Agencies	Corporate Bonds	Municipal Bonds	Total
AAA	\$	\$	\$2,500,000	\$	\$2,500,000
AA+			4,825,000	500,000	5,325,000
AA					525,000
AA-			7,500,000		7,500,000
A+			1,000,000		1,000,000
A					-
A-			175,000		175,000
BBB+			1,750,000		1,750,000
BBB				525,000	-
NR	4,500,000	500,000	\$225,000		5,225,000
Total	\$4,500,000	\$500,000	\$17,975,000	\$1,025,000	\$24,000,000



Investment Pricing

	Level 1	Level 2	Level 3	Total
U.S. Treasuries	\$4,500,000			\$4,500,000
U.S. Agencies		\$500,000		\$500,000
Corporate Bonds		\$17,975,000		\$17,975,000
Municipal Bonds		\$500,000	\$525,000	\$1,025,000
	\$4,500,000	\$18,975,000	\$525,000	\$24,000,000



What concerns you?

Let's take a few minutes to review what concerns you have over the investment process:

- + Do you have an investment policy?
- + Do you have investments rated below your investment policy?
- + Do you invest in hard to value investments?



Claims

Claims Process

Board Review (Financials and Actuarial)

- Claims Management (case reserves)
- Claims Management (losses paid)
- Actuarial Services (IBNR)
- Finance (financial statements and review of actuarial services)

Key Terms

IBNR

- Incurred But Not Reported, includes “unknown” and “known” but undeveloped

Loss Cost

- Dollar value of risk attached to an exposure

Paid Claims

- Amount paid for claims

Claim Reserves

- Dollars YET to be paid

Incurred Claims Expense

- Paid claims + chg in claim reserves + chg in IBNR

Loss Development

- Changes to claims estimate
- Quantified in actuary’s report



Loss Reserve – Board’s Questions

- What is the range provided by our actuary?
- Why are our reserves always deficient (unfavorable development of prior years’ reserves)?
- Why is our loss ratio fluctuating so much from year to year?
- Why does our actuary present to the Board a presentation?
- How did we vet our actuary?
- Is our actuary a specialist in our field?

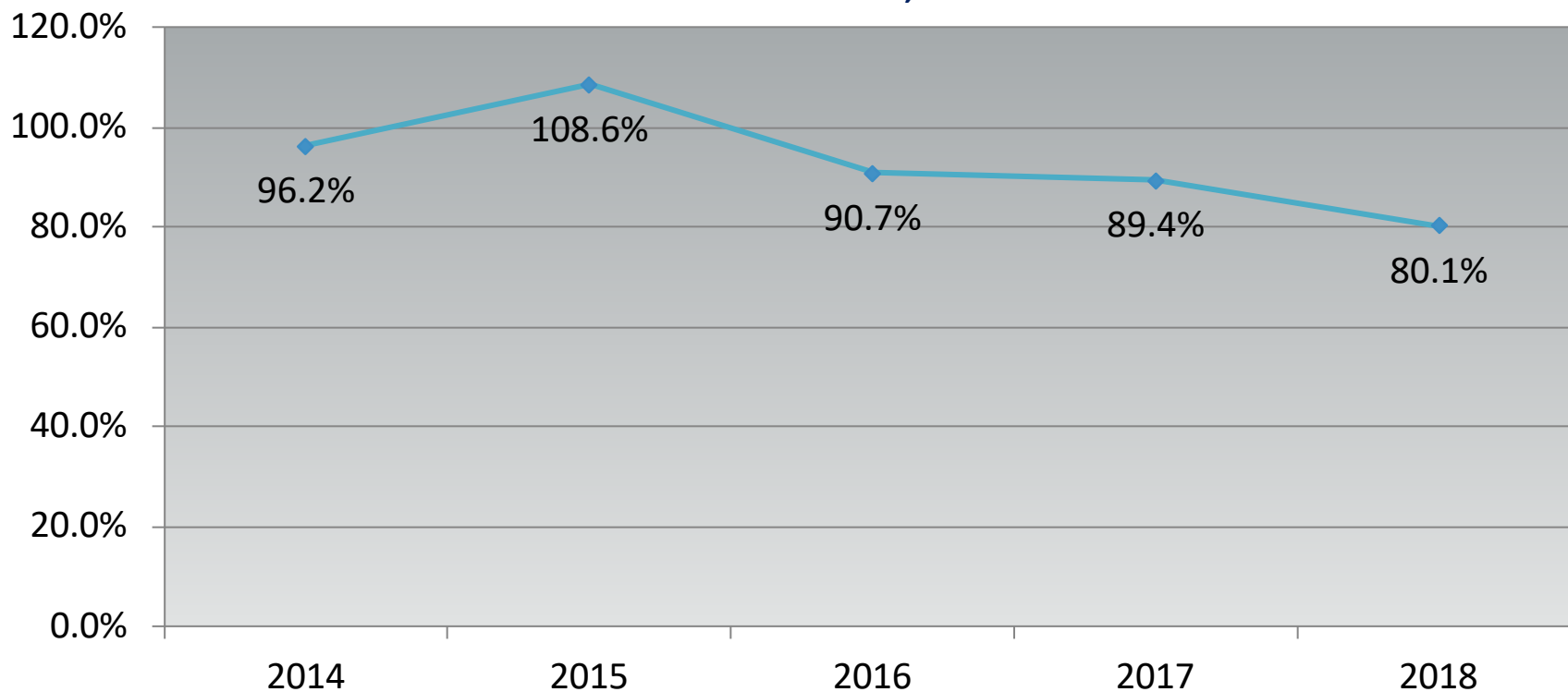


Loss Ratio

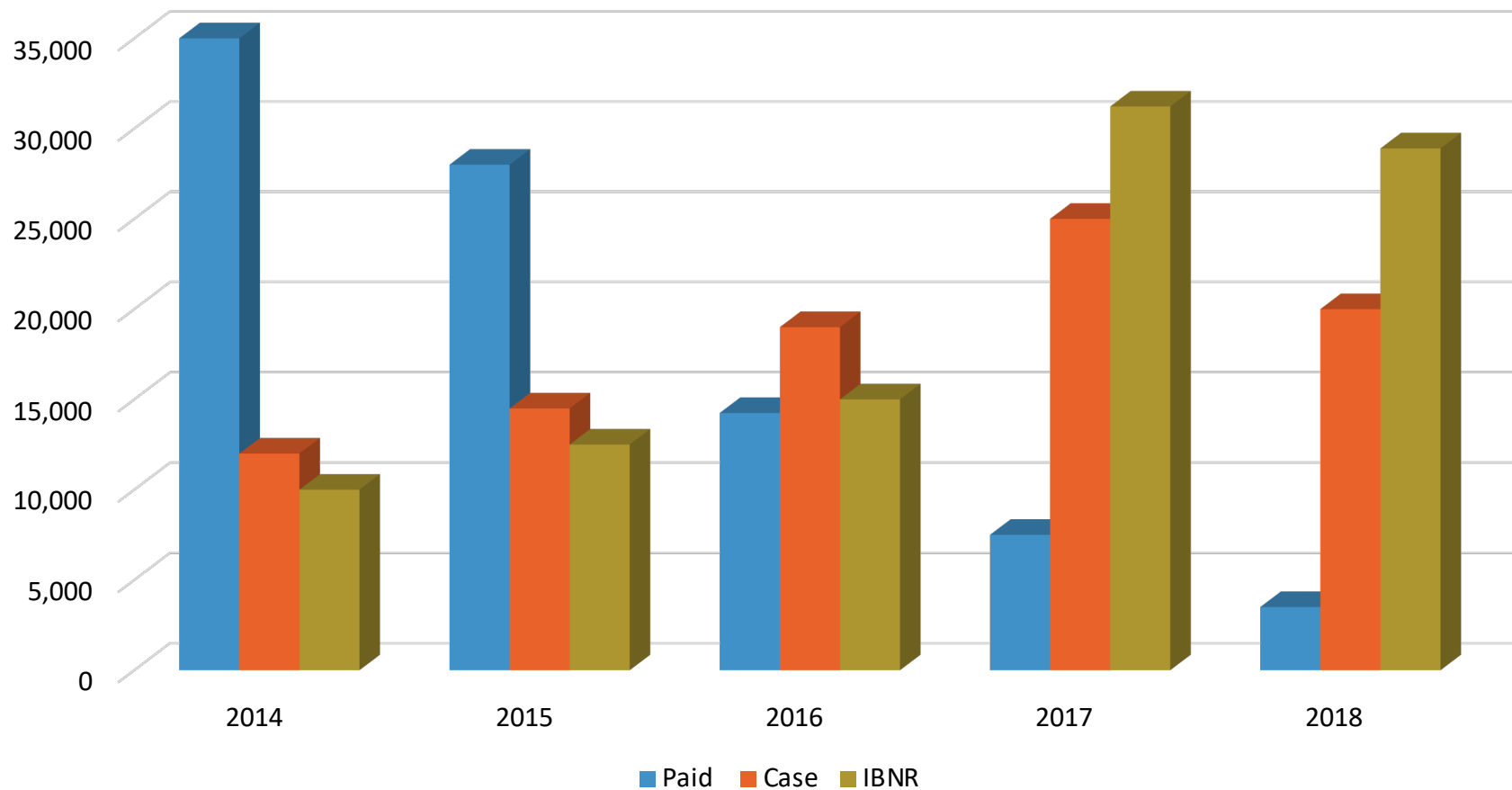
- Measure of the amount of each earned premium dollar set aside to pay claims

Losses & LAE Incurred, Net

Premiums Earned, Net



Composition of Ultimate Losses



Claim Liabilities

How to evaluate whether gross and net claim liabilities are reasonable?



GASB 10 year revenue and claims

Ten Year Claims Development Schedule (Unaudited)

Workers' Compensation Programs For the Year Ended

June 30, 2018

	Fiscal and Policy Year Ended (in thousands of dollars)									
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
(1) Net earned required premium and investment revenues	\$ 14,431	\$ 18,189	\$ 16,108	\$ 15,300	\$ 16,882	\$ 18,702	\$ 19,736	\$ 23,107	\$ 23,448	\$ 26,288
(2) Unallocated expenses	2,805	2,577	2,120	1,960	2,203	2,528	2,791	3,205	3,179	3,258
(3) Net estimated incurred claims and expense, end of policy year	14,495	15,212	14,940	14,782	16,656	18,812	18,320	18,330	21,629	27,148
(4) Net paid (cumulative) as of:										
End of policy year	6,206	4,549	5,604	5,780	7,448	7,477	7,317	6,973	7,004	10,645
One year later	7,069	7,099	8,398	8,289	10,451	11,153	10,824	9,486	12,721	
Two years later	8,275	8,226	9,933	9,707	11,904	12,940	11,993	11,765		
Three years later	9,484	8,910	11,351	10,864	12,554	13,718	12,863			
Four years later	10,101	9,569	11,910	12,104	12,719	14,664				
Five years later	10,828	10,507	12,536	13,068	13,527					
Six years later	11,528	11,303	12,907	13,889						
Seven years later	11,682	11,703	13,308							
Eight years later	11,825	11,965								
Nine years later	11,903									
(5) Reestimated net incurred claims and expenses										
End of policy year	14,495	15,212	14,940	14,782	16,656	18,812	18,320	18,330	21,629	27,148
One year later	14,195	14,456	15,211	14,093	16,563	18,180	19,072	18,056	21,092	
Two years later	14,906	14,002	14,373	14,321	16,602	17,712	17,917	18,545		
Three years later	14,659	13,895	13,941	14,827	16,268	17,680	18,627			
Four years later	14,595	13,889	13,910	14,669	16,632	17,507				
Five years later	14,259	13,887	14,263	15,200	16,838					
Six years later	14,086	14,546	14,166	15,013						
Seven years later	13,713	14,296	14,218							
Eight years later	13,915	14,426								
Nine years later	14,066									
(6) Increase (decrease) in estimated net incurred claims and expenses	\$ (429)	\$ (786)	\$ (722)	\$ 231	\$ 182	\$ (1,305)	\$ 307	\$ 215	\$ (537)	\$ -

Premium data

Total claim cost at 1st year

Paid claim data

Re-estimated claim cost over 10 years



What concerns you?

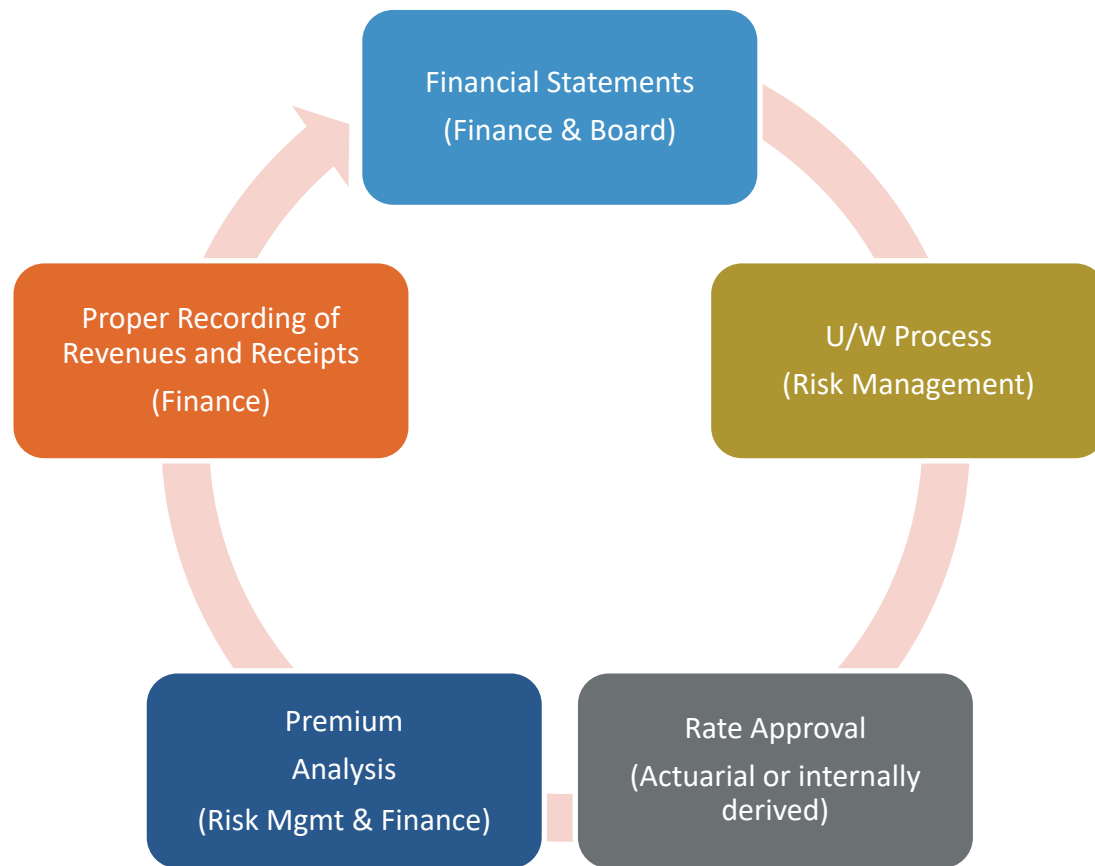
Let's take a few minutes to review what concerns you have over the claims process:

- + If your company is having higher than normal claim frequency what could help explain this?
- + What can you infer from the loss development schedule?

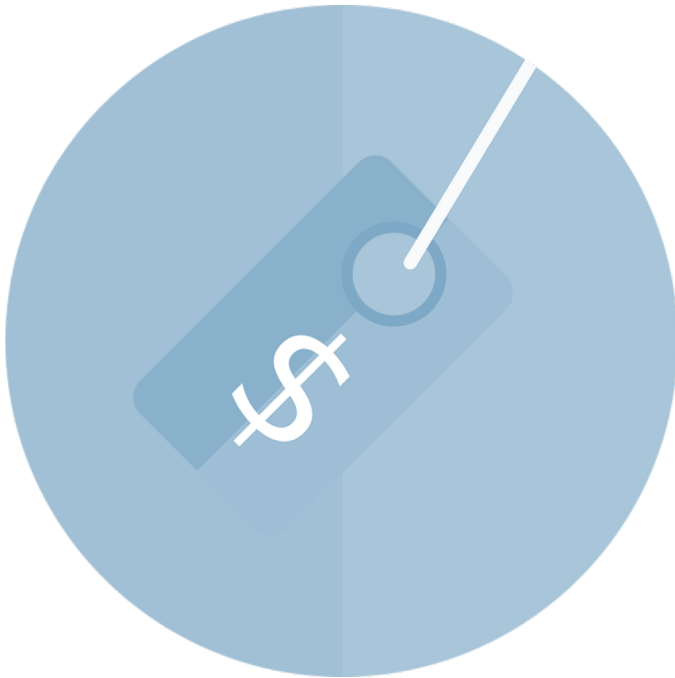


Underwriting

Underwriting Process



Direct Written Premiums



Pricing of Program

- Understanding of UW process
 - Rate changes
- Premium growth/decline
 - Premium receipts

Underwriting – Board's Questions

Why are we expanding so fast?

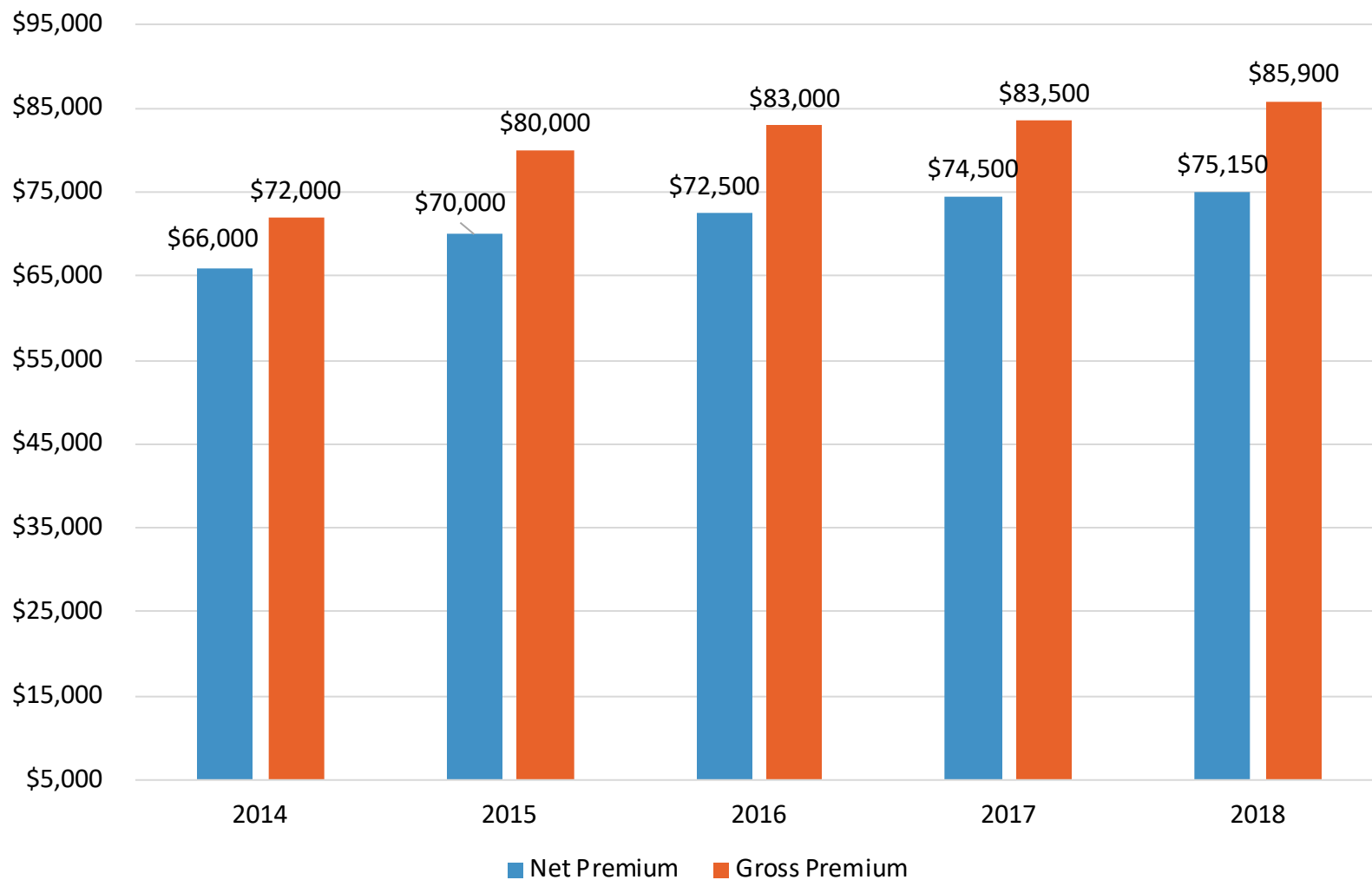
Why did we get into a new line of business?

How often do we waive our underwriting standards?

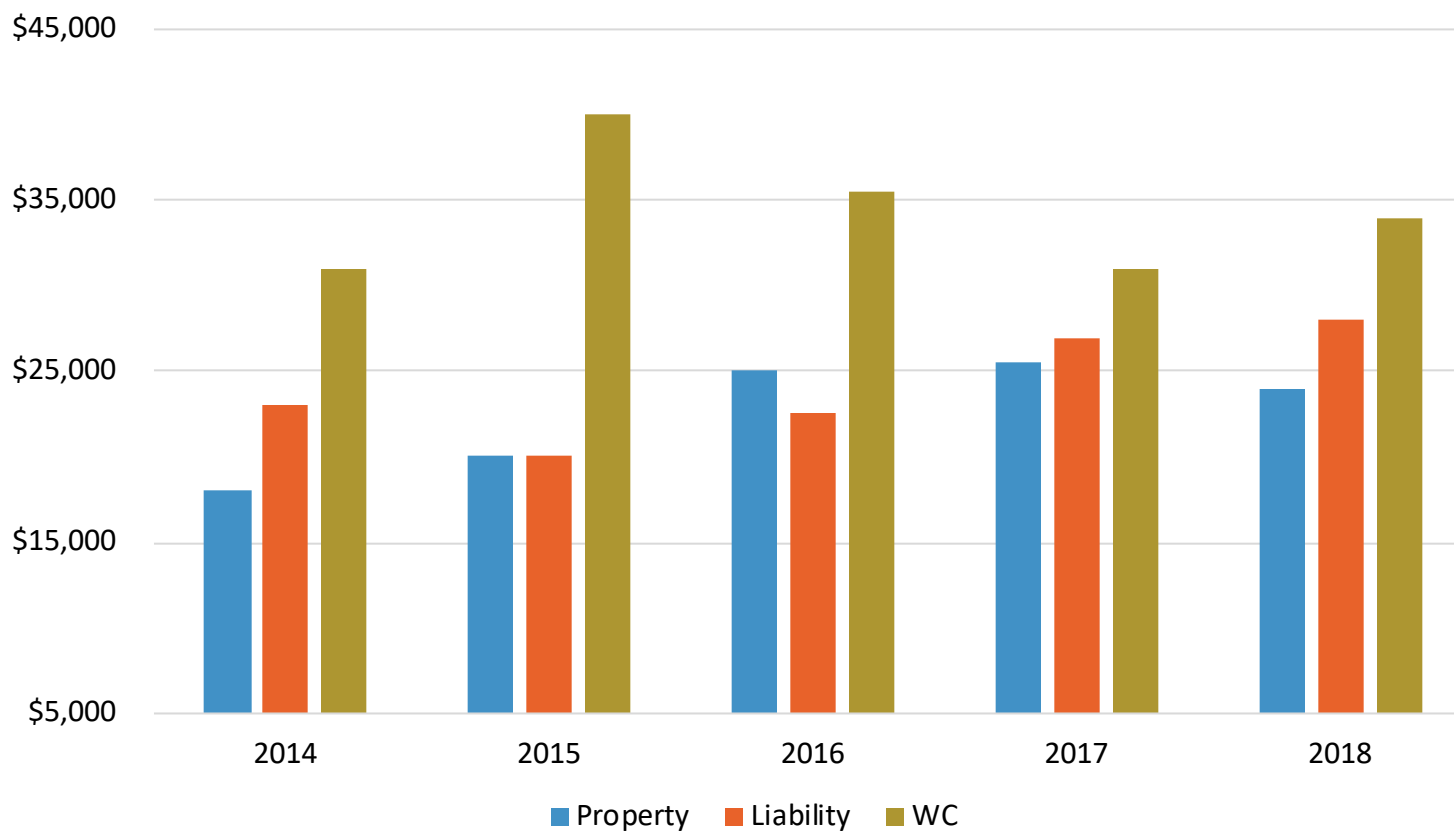
Why do we do business with reinsurers we have never heard of?



Trend in Premium (\$ thousands)



Gross written premium by LOB



What concerns you?

Let's take a few minutes to review what concerns you have over the underwriting process:

- + What would concern you over getting into a new line of business?
- + What questions would you have for management based on the level of premium growth?



Reinsurance

Reinsurance Considerations

Reliance on reinsurance. Some factors to consider include:



Net Position

Net Position

- Guides Governing Body in the use of Equity
- Specific Labels with Specific Purpose
- Proper restrictions on funds?

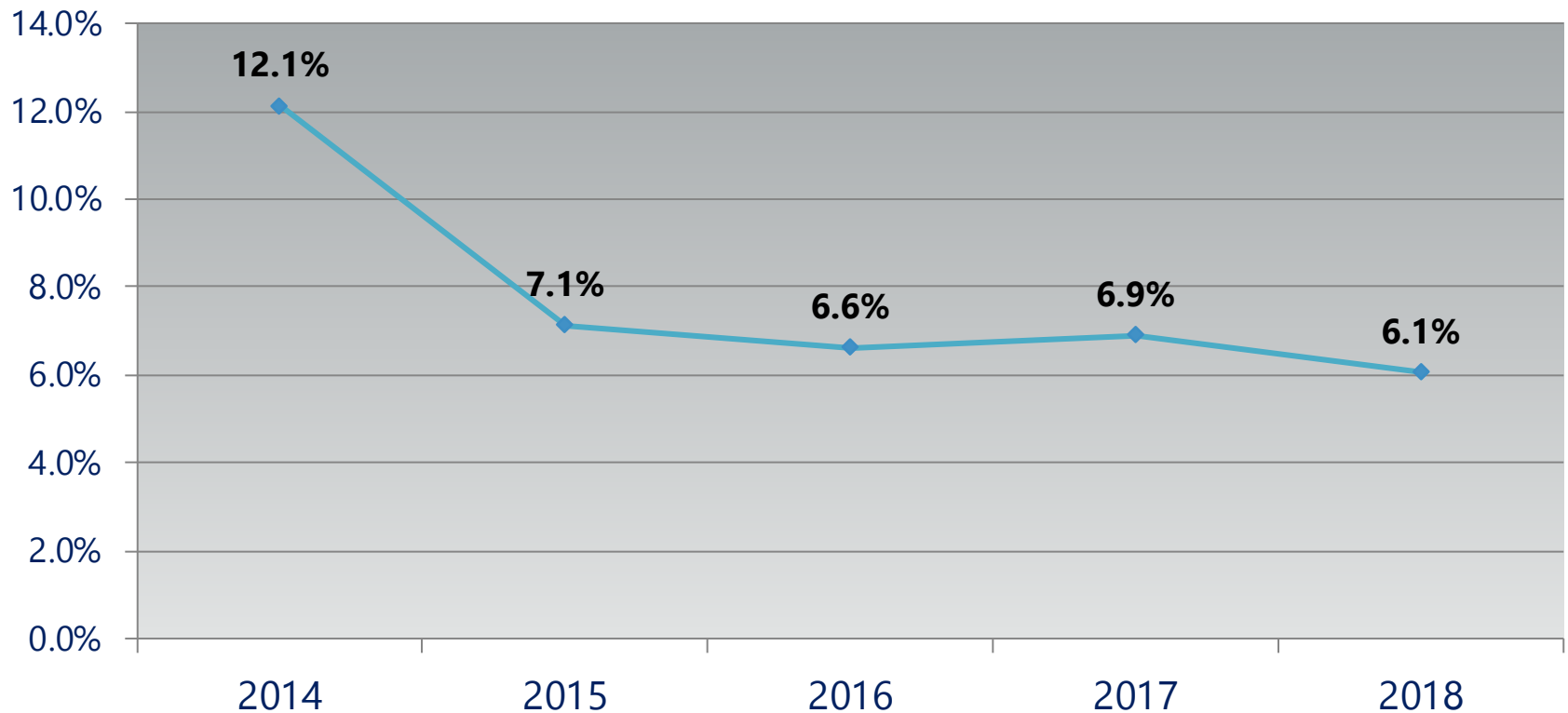


Expense Ratio

- Measure of the costs, other than claim costs, incurred to net written premiums

Total Underwriting Expenses (excluding Losses)

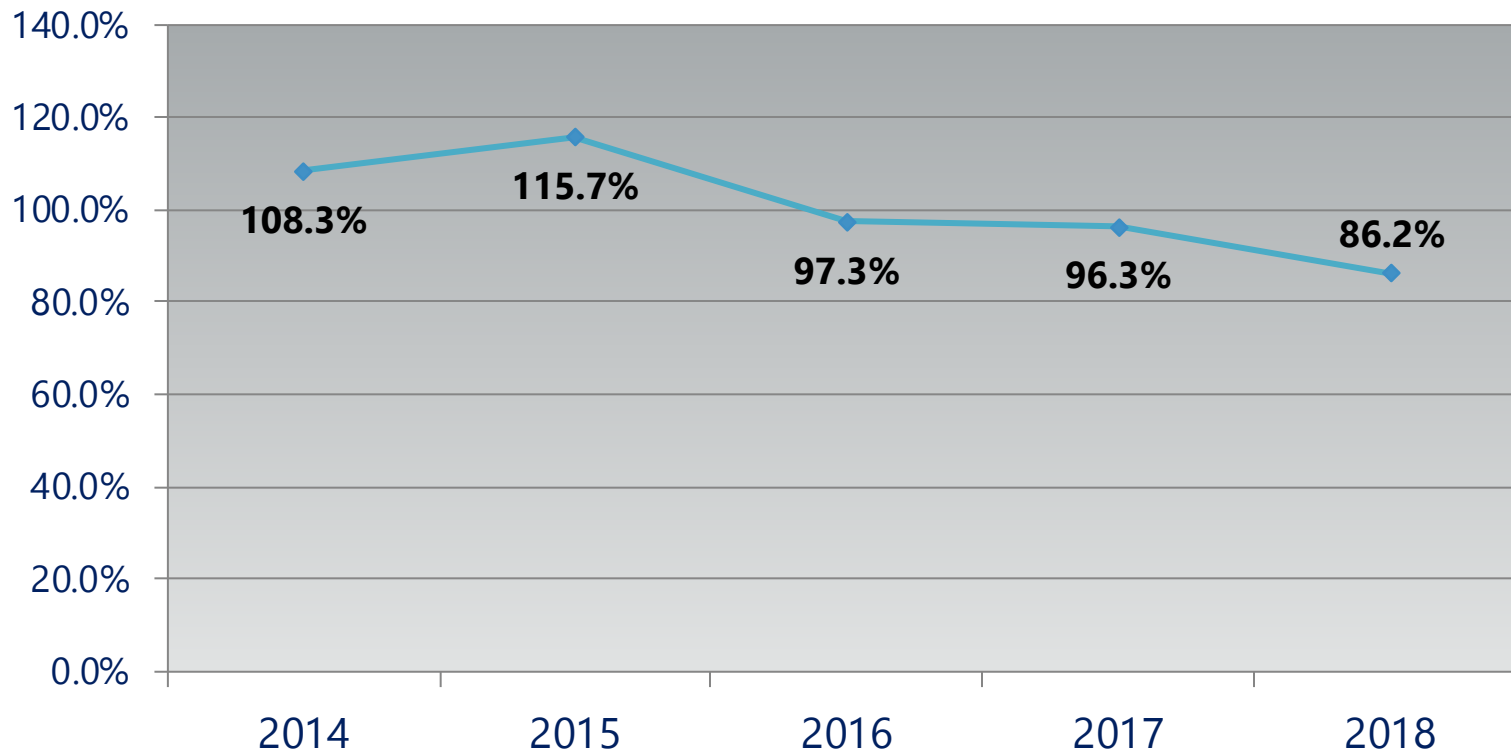
Net Premiums Written



Combined Ratio

- Combination of the loss and expense ratios

- Loss Ratio + Expense Ratio



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