

AUDIT REPORT

Local Government Group Insurance Fund

For the Year Ended
June 30, 2014



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
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January 6, 2015

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
Local Government Insurance Committee

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Local Government Group Insurance Fund for the year ended June 30, 2014. You will note from the independent auditor's report that an unmodified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA
Director

Audit Report
Local Government Group Insurance Fund
For the Year Ended June 30, 2014

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State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Local Government Group Insurance Fund

For the Year Ended June 30, 2014

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.



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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
Local Government Insurance Committee

Report on the Financial Statements

We have audited the accompanying financial statements of the Local Government Group Insurance Fund, an enterprise fund of the State of Tennessee, as of and for the years ended June 30, 2014, and June 30, 2013, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements as listed in the table of contents.

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 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 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.

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 Local Government Insurance Committee. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Local Government Group Insurance Fund.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Group Insurance Fund of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Local Government Group Insurance Fund, an enterprise fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2014, and June 30, 2013, and the changes in financial position and cash flows thereof for the years 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.

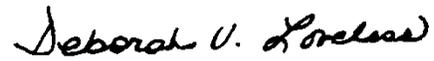
Other Matter - Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the ten-year claims development information on pages 11 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the 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 fund's internal control over financial reporting and compliance.



Deborah V. Loveless, CPA
Director
December 19, 2014

LOCAL GOVERNMENT GROUP INSURANCE FUND
Statements of Net Position
June 30, 2014, and June 30, 2013

(Expressed in Thousands)

	<u>June 30, 2014</u>	<u>June 30, 2013</u>
Assets		
Current assets:		
Cash (Note 2)	\$34,794	\$27,630
Accounts receivable	709	803
Total assets	35,503	28,433
Liabilities		
Current liabilities:		
Accounts payable and accruals (Note 3)	6,220	7,076
Unearned revenue	17	34
Total liabilities	6,237	7,110
Net position		
Unrestricted	29,266	21,323
Total net position	\$29,266	\$21,323

The notes to the financial statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
Statements of Revenues, Expenses, and Changes in Fund Net Position
For the Years Ended June 30, 2014, and June 30, 2013

(Expressed in Thousands)

	<u>Year Ended</u> <u>June 30, 2014</u>	<u>Year Ended</u> <u>June 30, 2013</u>
Operating revenues		
Premiums	\$108,811	\$105,972
Total operating revenues	108,811	105,972
Operating expenses		
Contractual services	5,916	4,866
Benefits	94,246	90,221
Other	729	1,269
Total operating expenses	100,891	96,356
Total operating income	7,920	9,616
Nonoperating revenues		
Interest income	23	1
Total nonoperating revenues	23	1
Increase in net position	7,943	9,617
Net position - beginning of year	21,323	11,706
Net position - end of year	\$ 29,266	\$ 21,323

The notes to the financial statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
Statements of Cash Flows
For the Years Ended June 30, 2014, and June 30, 2013

(Expressed in Thousands)

	<u>Year Ended June 30, 2014</u>	<u>Year Ended June 30, 2013</u>
Cash flows from operating activities		
Receipts from fund members	\$ 110,733	\$107,347
Payments to insurance companies and health care providers	(102,923)	(96,554)
Payments for state services	(669)	(1,269)
Net cash from operating activities	7,141	9,524
Cash flows from investing activities		
Interest received	23	1
Net cash from investing activities	23	1
Net increase in cash	7,164	9,525
Cash - beginning of the year	27,630	18,105
Cash - end of the year	\$ 34,794	\$ 27,630
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 7,920	\$ 9,616
Adjustments to reconcile operating income to net cash from operating activities:		
Changes in assets and liabilities:		
Change in accounts receivable	94	(188)
Change in accounts payable	(856)	126
Change in unearned revenue	(17)	(30)
Net cash from operating activities	\$ 7,141	\$ 9,524

The notes to the financial statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
Notes to the Financial Statements
June 30, 2014, and June 30, 2013

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The Local Government Group Insurance Fund is used to account for revenues received and claims paid on behalf of current employees of local governments and quasi-governmental organizations established for the primary purpose of providing services for or on behalf of state and local governments. The fund has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Measurement Focus and Basis of Accounting

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating revenues and expenses are distinguished from nonoperating items in the Local Government Group Insurance Fund. Operating revenues and expenses generally result from providing services in connection with the fund's principal ongoing insurance operations. Operating expenses include the cost of those services and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash

Cash is defined as cash on hand and demand deposits, such as the pooled investment fund.

Accounting Change

The Local Government Group Insurance Fund implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the fund was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

Notes to the Financial Statements (Continued)

Note 2. Deposits

The Local Government Group Insurance Fund had \$34,793,507 and \$27,629,736 in the State Treasurer's pooled investment fund at June 30, 2014, and June 30, 2013, respectively. The pooled investment fund, administered by the State Treasurer, is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and bills of the United States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies, and in securities lending agreements whereby securities may be loaned for a fee. The pooled investment fund's required risks disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov or by calling (615) 741-2956.

Note 3. Risk Management

The Local Government Group Insurance Fund, a public entity risk pool, was established in July 1991 to provide a program of health insurance coverage for employees of local governments and quasi-governmental organizations that were established for the primary purpose of providing services for or on the behalf of state and local governments. In accordance with Section 8-27-207, *Tennessee Code Annotated*, all local governments and quasi-governmental organizations described above are eligible to participate. Fund members at June 30, 2014, included 56 counties, 148 municipalities and 140 quasi-governmental organizations, with 12,429 active employees maintaining coverage through one of three options: partnership preferred provider organization (PPO) plan, standard (PPO) plan, or the PPO limited plan. The state does not retain any risk for losses by this fund.

The Local Government Group Insurance Fund assumes responsibility for determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, processing claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal laws and regulations. Plan participants are required to pay premiums on time, file claims for services received, report changes in eligibility of themselves or their dependents, and ensure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate a qualifying event to rejoin the plan. Employers must wait 24 months before rejoining the plan if the employer elects to withdraw from the plan.

The Local Government Group Insurance Fund establishes claims liabilities for self-insured options based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not

Notes to the Financial Statements (Continued)

necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Local Government Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Local Government Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	<u>2014</u>	<u>2013</u>
Unpaid claims at the beginning of the year	\$ 6,884	\$ 6,909
Incurred claims:		
Provision for insured events of the current year	97,731	93,862
Decrease in provision for insured events of prior years	(531)	(405)
Total incurred claims expenses	97,200	93,457
Payments:		
Claims attributable to insured events of the current year	91,708	87,025
Claims attributable to insured events of prior years	6,344	6,457
Total payments	98,052	93,482
Total unpaid claims at the end of the year	\$ 6,032	\$ 6,884

LOCAL GOVERNMENT GROUP INSURANCE FUND
Required Supplementary Information
Ten-Year Claims Development Information
Unaudited

The table below illustrates how the Local Government Group Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the fund for each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of the fund, including overhead and claims expense not allocable to individual claims. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year); some of these amounts are unavailable. (4) This section shows the cumulative amounts paid as of the end of successive years for each policy year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; some of these amounts are unavailable. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature fiscal years. The columns of the table show data for successive fiscal and policy years.

	Fiscal and Policy Year Ended (expressed in thousands of dollars)				
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
(1) Required contribution and investment revenue earned (fiscal year)	103,521	96,914	*89,240	*96,558	*103,157
(2) Unallocated expenses (fiscal year)	6,651	5,038	*3,398	*3,500	*4,348
(3) Estimated incurred claims and expenses, end of policy year	90,559	*87,058	*91,622	*94,655	*100,350
(4) Paid (cumulative) as of:					
End of policy year	81,924	*80,519	*84,836	*88,265	*93,456
One year later	*90,552	*86,934	*91,791	*94,820	*100,916
Two years later	*90,528	*86,981	*91,793	*95,029	*101,895
Three years later	*90,522	*86,974	*93,594	*94,993	*100,533
Four years later	*90,514	*86,974	*93,594	*94,991	*100,494
Five years later	*90,514	*86,974	*93,591	*94,991	**
Six years later	*90,514	*86,974	*93,591	**	
Seven years later	*90,514	*86,974	**		
Eight years later	*90,514	**			
Nine years later	**				

Ten-Year Claims Development Information (Continued)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
(5) Reestimated incurred claims and expenses:					
End of policy year	90,559	*87,058	*91,622	*94,655	*100,350
One year later	*90,476	*86,948	*91,801	*94,749	*100,803
Two years later	*90,525	*86,977	*91,788	*94,999	*101,895
Three years later	*90,517	*86,972	*93,594	*94,993	*100,492
Four years later	*90,514	*86,974	*93,594	*94,993	*100,492
Five years later	*90,514	*86,974	*93,594	*94,993	**
Six years later	*90,514	*86,974	*93,594	**	
Seven years later	*90,514	*86,974	**		
Eight years later	*90,514	**			
Nine years later	**				
(6) Increase (decrease) in estimated incurred claims and expenses from end of policy year	(45)	(84)	1,972	338	142

Fiscal and Policy Year Ended (expressed in thousands of dollars)

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
(1) Required contribution and investment revenue earned (fiscal year)	*104,810	*102,710	*103,278	*105,973	*108,834
(2) Unallocated expenses (fiscal year)	*5,921	*5,473	*6,010	*6,135	*6,645
(3) Estimated incurred claims and expenses, end of policy year	*107,083	*91,699	*94,738	*96,152	**
(4) Paid (cumulative) as of:					
End of policy year	*98,709	*89,231	*88,026	*89,634	**
One year later	*105,833	*91,703	*94,277	**	
Two years later	*107,170	*91,618	**		
Three years later	*107,103	**			
Four years later	**				
(5) Reestimated incurred claims and expenses:					
End of policy year	*107,083	*91,699	*94,738	*96,152	**
One year later	*106,870	*91,640	*94,248	**	
Two years later	*106,720	*91,558	**		
Three years later	*106,697	**			
Four years later	**				
(6) Increase (decrease) in estimated incurred claims and expenses from end of policy year	(386)	(141)	(490)	0	**

* Amounts only represent active employees (due to implementation of the Governmental Accounting Standards Board's Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*).

** Data not available.



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**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***

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
Local Government Insurance Committee

We have audited the financial statements of the Local Government Group Insurance Fund as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated December 19, 2014. 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 Local Government Group Insurance Fund'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 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 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

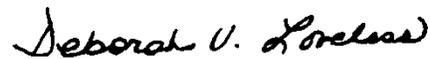
material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Local Government Group Insurance Fund's financial statements are free from 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*.

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

December 19, 2014