

Local Government Group Insurance Fund

**For the Year Ended
June 30, 1996**

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August 11, 1997

The Honorable Don Sundquist, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and

The Honorable John Ferguson, Chairman
Local Government Group Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Local Government Group Insurance Fund for the year ended June 30, 1996. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of the internal control structure and tests of compliance disclosed a deficiency, which is detailed in the Observations and Comments section of this report. The Department of Finance and Administration's management has responded to the audit finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/cr
97/036

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Local Government Group Insurance Fund
For the Year Ended June 30, 1996

AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control structure; to determine the fairness of the presentation of the financial statements; to determine compliance with laws, regulations, and contracts; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

This audit report contains no findings; however, a finding regarding the weak computer controls over the Tennessee Insurance System (TIS) was included in the 1996 Department of Finance and Administration Audit Report. The Department of Finance and Administration maintains participant information such as coverage type and status, eligible dependents, and premiums due and payment history for the Teacher Group Insurance Fund on TIS.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

Audit Report
Local Government Group Insurance Fund
For the Year Ended June 30, 1996

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Local Government Group Insurance Fund For the Year Ended June 30, 1996

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Local Government Group Insurance Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the fund’s internal control structure to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine the fairness of the presentation of the financial statements;
3. to determine compliance with laws, regulations, and contracts; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act of 1984 and Office of Management and Budget (OMB) Circular A-128, “Audits of State and Local Governments,” it included tests of compliance with applicable federal laws and regulations and consideration of the internal control structure used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act of 1984 and OMB Circular A-128.

SCOPE OF THE AUDIT

The audit was limited to the period July 1, 1995, through June 30, 1996, and was conducted in accordance with generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 1996, and for comparative purposes, the year ended June 30, 1995. The Local Government Group Insurance Fund forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund 58 of the State of Tennessee Accounting and Reporting System.

BACKGROUND AND ORGANIZATION

LEGISLATIVE HISTORY

The Local Government Group Insurance Committee was created in July 1991 by an act of the General Assembly, codified as Title 8, Chapter 27, *Tennessee Code Annotated*. The purpose of the committee is 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 behalf of state and local governments.

ORGANIZATION

The Local Government Group Insurance Committee oversees the administration of the fund. The insurance committee is composed of the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, one representative appointed by the Tennessee Municipal League, and one representative appointed by the Tennessee County Services Association.

The Department of Finance and Administration, Division of Insurance Administration, is responsible for processing all payments and cash receipts of the fund through the state's accounting system.

The contractor, Blue Cross and Blue Shield of Tennessee, Inc., processes all participant claims, makes all claim payments, provides access to a preferred provider organization, and carries out utilization management functions.

An organization chart of the fund's administration is on the following page.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

The Division of Insurance Administration maintains participant information such as coverage type and status, eligible dependents, employment status, premiums due and payment history for the Local Government Insurance Fund on the Tennessee Insurance System (TIS). A finding regarding the computer controls over TIS was included in the 1996 Department of Finance and Administration Audit Report. Specifically, daily activity recorded in TIS does not agree with the corresponding State of Tennessee Accounting and Reporting System (STARS) accounting transactions, nor can it be completely reconciled. Each day the Division of Insurance Administration enters insurance collections, refunds, and other related transactions into TIS. The Division of Accounts then compares the net change in the TIS database each day to the cumulative accounting transactions passed from TIS to STARS as a result of the TIS/STARS interface. Through this daily reconciliation process, the Division of Accounts corrects any differences that can be identified. Management concurred with the finding and has established a work group to identify and remedy the problems related to the balancing issues between TIS and STARS.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control Structure

As part of the audit of the Local Government Group Insurance Fund's financial statements for the year ended June 30, 1996, we considered the internal control structure to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards. The report on the internal control structure is on the following pages. A reportable condition, is detailed in the Observations and Comments section of the report. Consideration of the internal control structure disclosed no material weaknesses.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the Local Government Group Insurance Fund. In our opinion, the statements included in this report present fairly, in all material respects, the financial position of the fund as of June 30, 1996, and the results of its operations and cash flows for the year then ended. The independent auditor's report follows the compliance report.

Compliance with Laws and Regulations

The results of our audit tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards. The compliance report follows the report on the internal control structure.

**Report on the Internal Control Structure Based on an
Audit of the Financial Statements Performed in Accordance With
*Government Auditing Standards***

December 20, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Local Government Group Insurance Fund as of and for the year ended June 30, 1996, and have issued our report thereon dated December 20, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The fund's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the fund's financial statements for the year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted a matter involving the internal control structure and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

We noted the following reportable condition:

- The Tennessee Insurance System and the State of Tennessee Accounting and Reporting System do not reconcile

This condition is described in the Observations and Comments section of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we do not believe the reportable condition described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to the fund's management in a separate letter.

The Honorable W. R. Snodgrass
December 20, 1996
Page Three

This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

**Compliance Report Based on an Audit of the
Financial Statements Performed in Accordance
With *Government Auditing Standards***

December 20, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Local Government Group Insurance Fund as of and for the year ended June 30, 1996, and have issued our report thereon dated December 20, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, and contracts applicable to the Local Government Group Insurance Fund is the responsibility of the fund's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the fund's compliance with certain provisions of laws, regulations, and contracts. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards.

The Honorable W. R. Snodgrass
December 20, 1996
Page Two

This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

Independent Auditor's Report

December 20, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Local Government Group Insurance Fund as of June 30, 1996, and June 30, 1995, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, as of June 30, 1996, and June 30, 1995, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The Honorable W. R. Snodgrass
December 20, 1996
Page Two

In accordance with generally accepted government auditing standards, we have also issued reports dated December 20, 1996, regarding our consideration of the fund's internal control structure and its compliance with laws and regulations.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE BALANCE SHEETS
JUNE 30, 1996, AND JUNE 30, 1995

(Expressed in Thousands)

	<u>June 30, 1996</u>	<u>June 30, 1995</u>
<u>ASSETS</u>		
Current assets:		
Cash (Notes 1 and 2)	\$ 10,859	\$ 11,043
Accounts receivable	430	591
Due from component units	<u>-</u>	<u>4</u>
Total assets	\$ <u><u>11,289</u></u>	\$ <u><u>11,638</u></u>
 <u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Current liabilities:		
Warrants payable	\$ 1,100	\$ 183
Accounts payable and accruals	5,742	6,294
Due to component units	4	1
Deferred revenue	<u>26</u>	<u>23</u>
Total liabilities	<u>6,872</u>	<u>6,501</u>
Equity:		
Retained earnings, unreserved	<u>4,417</u>	<u>5,137</u>
Total equity	<u>4,417</u>	<u>5,137</u>
Total liabilities and equity	\$ <u><u>11,289</u></u>	\$ <u><u>11,638</u></u>

The Notes to the Financial Statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS
FOR THE YEARS ENDED JUNE 30, 1996, AND JUNE 30, 1995

(Expressed in Thousands)

	<u>Year Ended June 30, 1995</u>	<u>Year Ended June 30, 1994</u>
<u>OPERATING REVENUES</u>		
Premiums	\$ <u>34,205</u>	\$ <u>40,085</u>
 <u>OPERATING EXPENSES</u>		
Contractual services	706	753
Rentals and insurance	4,014	756
Benefits	30,138	33,484
Other	<u>719</u>	<u>99</u>
Total operating expenses	<u>35,577</u>	<u>35,092</u>
Operating income (loss)	<u>(1,372)</u>	<u>4,993</u>
 <u>NONOPERATING REVENUES</u>		
Interest income	<u>652</u>	<u>504</u>
Net income (loss)	(720)	5,497
Retained earnings, July 1	<u>5,137</u>	<u>(360)</u>
Retained earnings, June 30	\$ <u><u>4,417</u></u>	\$ <u><u>5,137</u></u>

The Notes to the Financial Statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1996, AND JUNE 30, 1995

(Expressed in Thousands)

	<u>June 30, 1996</u>	<u>June 30, 1995</u>
Cash flows from operating activities:		
Operating income (loss)	\$ <u>(1,372)</u>	\$ <u>4,993</u>
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:		
Change in assets and liabilities:		
Decrease in accounts receivable	161	(40)
Decrease in due from component units	4	8
Increase (decrease) in warrants payable	917	(666)
Decrease in accounts payable and accruals	(552)	(1,097)
Increase in due to component units	3	1
Increase in deferred revenue	<u>3</u>	<u>13</u>
Total adjustments	<u>536</u>	<u>(1,781)</u>
Net cash provided by (used for) operating activities	<u>(836)</u>	<u>3,212</u>
Cash flows from investing activities:		
Interest received	<u>652</u>	<u>504</u>
Net cash provided by investing activities	<u>652</u>	<u>504</u>
Net increase (decrease) in cash	(184)	3,716
Cash, July 1	<u>11,043</u>	<u>7,327</u>
Cash, June 30	\$ <u><u>10,859</u></u>	\$ <u><u>11,043</u></u>

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, 1996, and June 30, 1995

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Local Government Group Insurance Fund is used to account for health insurance revenues received and claims paid on behalf of 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 is part of the primary government and has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Local Government Group Insurance Fund follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

D. Cash

Cash is defined as cash on hand, demand deposits, such as the pooled investment fund, and investments with three months or less to maturity when purchased.

Local Government Group Insurance Fund
Notes to the Financial Statements (Cont.)
June 30, 1996, and June 30, 1995

NOTE 2. DEPOSITS

The Local Government Group Insurance Fund had \$10,858,705 in the State Treasurer's pooled investment fund at June 30, 1996, and \$11,043,110 at June 30, 1995.

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, certain repurchase agreements, various U. S. Treasury and agency obligations, limited money market mutual funds, and obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The pooled investment fund is also authorized to enter into securities lending agreements in which U. S. government securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 1996.

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 behalf of state and local governments. In accordance with *Tennessee Code Annotated*, Section 8-27-207, all local governments and quasi-governmental organizations described above are eligible to participate. The fund at June 30, 1996, covered 10,634 employees and 142 retirees from 242 local governments and quasi-governmental organizations. 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

Local Government Group Insurance Fund
Notes to the Financial Statements (Cont.)
June 30, 1996, and June 30, 1995

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 insurability to rejoin the plan. Employers must wait 24 months before rejoining the plan if the employer elects to withdraw from the plan. In the case of the individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.

The Local Government Group Insurance Fund establishes claims liabilities 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 necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 18 percent of the prior 12 months' claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Local Government Group Insurance Fund does not consider investment income in determining if a premium deficiency exists, as any earnings are immaterial.

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 (expressed in thousands) in those aggregate liabilities during the past two years.

	<u>1996</u>	<u>1995</u>
Unpaid claims at beginning of year	<u>\$ 6,277</u>	<u>\$ 7,179</u>
Incurred claims, provision for insured events of the current fiscal year	<u>30,526</u>	<u>33,971</u>
Total incurred claims expenses	36,803	41,150
Payments	<u>31,185</u>	<u>34,873</u>
Total unpaid claims at end of year	<u><u>\$ 5,618</u></u>	<u><u>\$ 6,277</u></u>

LOCAL GOVERNMENT GROUP INSURANCE FUND
REQUIRED SUPPLEMENTARY INFORMATION
FIVE-YEAR CLAIMS DEVELOPMENT INFORMATION

(Expressed in Thousands)

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 Local Government Group Insurance Fund as of the end of each of the last five years since the inception of the fund. 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.* (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. (4) This section shows the cumulative amounts paid as of the end of successive years for each policy year. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; these amounts are unavailable for prior years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, and 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 policy years. The columns of the table show data for successive policy years.

	Fiscal Year Ended June 30				
	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
(1) Net earned required contribution and investment revenues	\$21,805	\$30,633	\$41,819	\$40,589	\$34,857
(2) Unallocated expenses	519	621	1,267	852	1,425
(3) Estimated incurred claims and expenses, end of fiscal year	19,752	30,128	41,865	33,483	30,138
(4) Paid (cumulative) as of:					
End of policy year	16,765	*	*	*	*
One year later	*	*	*	*	
Two years later	*	*			
Three years later	*				
Four years later	*				
(5) Reestimated incurred claims and expenses:					
End of policy year	19,752	30,128	41,865	33,483	30,138
One year later	*	*	*	*	
Two years later	*	*	*		
Three years later	*	*			
Four years later	*				
(6) Increase (decrease) in estimated incurred claims and expenses from end of policy year	*	-	-	-	-

* Data not available

