

The Minnesota Self- Insurers' Security Fund

Financial Statements
(With Independent Auditor's Report Thereon)
June 30, 2017 and 2016

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RSM US LLP

Independent Auditor's Report

To the Board of Trustees
The Minnesota Self-Insurers' Security Fund

Report on the Financial Statements

We have audited the accompanying financial statements of The Minnesota Self-Insurers' Security Fund (the Fund), which comprise the balance sheets as of June 30, 2017 and 2016; the related statements of revenues and expenses, members' equity (deficit) and cash flows for the years then ended; and the related notes to the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 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 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Minnesota Self-Insurers' Security Fund as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Minneapolis, Minnesota
October 10, 2017

The Minnesota Self-Insurers' Security Fund

Balance Sheets June 30, 2017 and 2016

	2017	2016
Assets		
Cash and cash equivalents	\$ 1,544,957	\$ 1,013,021
Investments	2,894,248	2,573,196
Security deposit receivable	105,684	195,616
Reinsurance receivables	8,327,502	8,468,548
Member assessment and interest receivables	664	4,973
Prepaid expenses	3,304	4,214
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Total assets	\$ 12,876,359	\$ 12,259,568
Liabilities and Members' Equity (Deficit)		
Liabilities:		
Accounts payable	\$ 2,862	\$ 4,957
Deferred revenue	467,509	457,800
Estimated liability for incurred, incurred but unreported, and incomplete claims	12,616,526	13,420,596
Total liabilities	13,086,897	13,883,353
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Members' equity (deficit)	(210,538)	(1,623,785)
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Total liabilities and members' equity (deficit)	\$ 12,876,359	\$ 12,259,568

See notes to financial statements.

The Minnesota Self-Insurers' Security Fund

Statements of Revenues and Expenses Years Ended June 30, 2017 and 2016

	2017	2016
Revenues:		
General membership assessment	\$ 1,791,574	\$ 1,764,553
Terminated member assessments and other revenue	9,347	5,720
Investment income	134,532	43,143
Total revenues	1,935,453	1,813,416
Expenses:		
Claims incurred, net of recoveries and change in estimated liabilities	81,113	(914)
Professional fees attributed to bankruptcies	11,146	13,247
Claims administration fees	67,394	67,820
Professional and administrative	362,553	325,504
Total expenses, including change in estimated liabilities	522,206	405,657
Excess of revenues over expenses	\$ 1,413,247	\$ 1,407,759

Statements of Members' Equity (Deficit) Years Ended June 30, 2017 and 2016

	2017	2016
Balance (deficit), beginning	\$ (1,623,785)	\$ (3,031,544)
Excess of revenues over expenses	1,413,247	1,407,759
Balance (deficit), ending	\$ (210,538)	\$ (1,623,785)

See notes to financial statements.

The Minnesota Self-Insurers' Security Fund

Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Excess of revenues over expenses	\$ 1,413,247	\$ 1,407,759
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Net unrealized and realized gains and losses on investments	(76,738)	(13,993)
Changes in assets and liabilities:		
Security deposit receivable	89,932	14,037
Reinsurance and other receivables	(26,578)	(35,178)
Prepaid expenses	910	(389)
Accounts payable	(2,095)	(51,863)
Deferred revenue	9,709	10,903
Estimated liability for incurred, incurred but unreported, and incomplete claims	(632,137)	(308,731)
Net cash provided by operating activities	776,250	1,022,545
Cash flows from investing activities:		
Purchases of investments	(9,777,269)	(10,903,536)
Proceeds from sales and maturities of investments	9,532,955	8,344,333
Net cash used in investing activities	(244,314)	(2,559,203)
Increase (decrease) in cash and cash equivalents	531,936	(1,536,658)
Cash and cash equivalents:		
Balance, beginning	1,013,021	2,549,679
Balance, ending	\$ 1,544,957	\$ 1,013,021

See notes to financial statements.

The Minnesota Self-Insurers' Security Fund

Notes to Financial Statements

Note 1. Nature of Operations and Significant Accounting Policies

Nature of operations: The Minnesota Self-Insurers' Security Fund (the Fund) was incorporated under the Minnesota Non-Profit Act on September 9, 1988, and certain rights and obligations were enacted by law as of September 29, 1988. A 10-member Board of Trustees governs the Fund. The purpose of the Fund is to fulfill the obligations placed upon it by Minnesota Statutes, Chapter 79A, as summarized below.

Employers who are private self-insurers of workers' compensation benefits on or after July 1, 1988, in the state of Minnesota, as identified by the Commissioner of the Minnesota Department of Commerce (the Commissioner), are required to be members of this Fund. The Commissioner makes the initial determination of which employers are qualified to be self-insured. The Commissioner also has the authority to revoke the employers' certificate to self-insure.

The Fund is liable for the administration and payment of workers' compensation benefits when a self-insured member declares bankruptcy or becomes insolvent and the Commissioner issues a certificate of default. The Fund has the right to obtain reimbursement from the bankrupt or insolvent member, is entitled to any subrogation or reinsurance that the member was entitled to, and also has the right to receive the security deposit that the member has provided to the Commissioner. Minnesota Statutes, Chapter 79A, states that the security deposit is to be equal to 110 percent of the member's estimated future workers' compensation liability as determined by an actuary. The security deposit may be in the form of a bond, letter of credit, or cash deposit; is held and regulated by the Commissioner; and is not within the control of the Fund. If the assumed liabilities of the bankrupt or insolvent member exceed these sources of revenues, the Fund may assess its members a pro rata share (subject to annual limitation) of the funding necessary to carry out the Fund's remaining claim payment obligations and to cover the reasonable costs of administering the Fund.

The Fund has a service agreement with Berkley Risk Administrators Company (Berkley) to provide administration of claims for which the Fund is responsible. There is an administration fee charged by Berkley. This service agreement is effective through June 30, 2018.

A summary of the Fund's significant accounting policies follows:

Management estimates: The preparation of financial statements requires the trustees to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the estimated liability for incurred, incurred but unreported, and incomplete claims.

Assessments: Member assessments are recognized as revenue in the period in which the assessment is made by the Fund. Assessments are based on the members' workers' compensation indemnity benefits paid during the previous calendar year. Assessments by the Fund cannot exceed 10 percent of the indemnity benefits paid by the members during the calendar year. A 4 percent assessment was made in the years ended June 30, 2017 and 2016.

The Fund has the authority to assess employers who have terminated their self-insurance status. Departing members are assessed their proportionate share of the Fund's current liability.

Cash and cash equivalents: For purposes of reporting the statement of cash flows, the Fund considers all savings accounts, bankers' acceptances, money market mutual funds, and all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Bankers' acceptances of \$1,022,511 and \$280,820 are included in cash and cash equivalents at June 30, 2017 and 2016, respectively.

The Minnesota Self-Insurers' Security Fund

Notes to Financial Statements

Note 1. Nature of Operations and Significant Accounting Policies (Continued)

The Fund maintains its cash in bank deposit, checking and money market accounts, which generally exceed federally insured limits. At June 30, 2017 and 2016, cash and cash equivalents, other than bankers' acceptances securities, which are recorded at fair value, are recorded at cost, which approximates fair value because of the short-term nature of these instruments.

Investments and investment income: Investments in mutual funds and bankers' acceptances are recorded at their fair value on the balance sheets. Unrealized gains and losses are included in investment income on the statements of revenues and expenses. Investment fees are reported within professional and administrative expenses on the statements of revenues and expenses.

Estimated liability for incurred, incurred but unreported, and incomplete claims: The liabilities assumed from the bankrupt or insolvent members for incurred but not reported and incomplete claims and claim administration expenses are estimated by management after consultation with an independent actuary based on loss reserves, paid claims, industry data and general conditions of the environment associated with these claims. These liabilities are necessarily based on estimates, and the ultimate liability may be in excess of or less than the amounts stated. The variability of the liability is increased where there is a lack of historical data available and because the claims may be in connection with employers that are no longer in operation.

The unpaid claims and claim adjustment expense estimates are continually reviewed and, as adjustments to the estimated liabilities become necessary, such adjustments will be reflected in the year they are determined.

Reinsurance: When the Fund becomes legally liable for the claim liabilities of a bankrupt or insolvent member, it is entitled to receive any reinsurance that the member was entitled to. Under state law, all Minnesota self-insurers are required to be members of the Minnesota Workers' Compensation Reinsurance Association (WCRA). The Fund has applied for, and continues to receive, recoveries from reinsurance for certain paid claims in excess of the WCRA retention limits. The Fund has also pursued subrogation from various third parties and continues to receive recoveries. The Fund receives reinsurance recoveries from Erieview Insurance Company, Ltd. (Erieview), a captive insurance company that reinsured the National Steel Corporation and its subsidiary, National Steel Pellet Company (National Steel) (see Note 3). Total reinsurance and subrogation recoveries on paid claims were approximately \$457,000 and \$406,000 in 2017 and 2016, respectively.

The Fund also estimates the future recoveries it expects to receive from the WCRA, Erieview and any other reinsurers as they relate to the estimated liability for incurred, incurred but unreported, and incomplete claims and records the expected recoveries as reinsurance receivable. The estimated amount recoverable from these reinsurers was approximately \$8,328,000 and \$8,469,000 at June 30, 2017 and 2016, respectively. Expected recoveries are netted against claims incurred on the statements of revenues and expenses.

Subsequent events: All of the effects of subsequent events that provide additional evidence about conditions that existed at the financial statement date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. The Fund does not recognize subsequent events that provide evidence about conditions that did not exist at the financial statement date but arose after, but before the financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the financial statements from being misleading (see Note 5).

The Minnesota Self-Insurers' Security Fund

Notes to Financial Statements

Note 1. Nature of Operations and Significant Accounting Policies (Continued)

The Fund has considered subsequent events through October 10, 2017, the date that the financial statements were available to be issued, in preparing the financial statements and notes thereto.

Tax status: The Fund is generally exempt from federal and state taxation as a qualified tax-exempt organization under Internal Revenue Code 501(c)(6).

Accounting standards not yet adopted: Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, as revised by ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, will be effective for the Fund for the year ending June 30, 2020. Early application is permitted for the Fund for the year ending June 30, 2019. This standard update requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods or services. The Fund has not yet determined the effect this ASU will have on the Fund's financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This ASU requires, among other items, disclosures of information that communicates how an entity manages its liquid resources to meet current expenditure needs, presentation of expenses by both their natural and functional classifications, and reporting of investment return net of investment expenses. The ASU is effective for the Fund for the year ending June 30, 2019. The Fund has not yet determined the effect this ASU will have on its financial statements.

Note 2. Investments and Investment Income

Investment income: Investment income consists of earnings on investments. For the years ended June 30, 2017 and 2016, investment income consists of the following:

	2017	2016
Investments:		
Interest, dividends and capital gain distributions	\$ 57,794	\$ 29,150
Realized gains (losses), net	3,970	726
Unrealized gains (losses), net	72,768	13,267
	<u>\$ 134,532</u>	<u>\$ 43,143</u>

Assets and liabilities recorded at fair value on the balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Input levels, as defined by the accounting guidance for fair value measurements, are as follows:

Level 1: Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date. Fair values of actively traded money market funds, mutual funds and equity securities are based on quoted market prices.

Level 2: Inputs are other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3: Inputs are unobservable and reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Minnesota Self-Insurers' Security Fund

Notes to Financial Statements

Note 3. Member Liabilities Assumed

The Fund, since its inception, has assumed the liabilities for the payment of workers' compensation benefits and the costs of settling these claims from 14 former members who have declared bankruptcy or are insolvent. One new member obligation was assumed in fiscal year 2017 and none were assumed in fiscal year 2016. The member assumed in 2017 has no open claims that do not exceed reinsurance retention limits, which resulted in no additional net loss liability. Therefore, no effect to members' equity (deficit) is anticipated on the member assumed in 2017 other than future expected claims adjudication costs. The Fund receives the proceeds of the bankrupt or insolvent members' security deposits and recognizes these deposits as revenue at the lesser of the deposit received or the Fund's estimate of the claims liability assumed (see Note 4). Amounts received in excess of the claims liability assumed are reported as deferred revenue.

In June 2003, the Fund assumed the workers' compensation liabilities for National Steel, a former member of the Fund. Shortly after the Fund assumed these liabilities, it began pursuing reinsurance reimbursement from Erieview, a National Steel-affiliated captive insurance company, on several National Steel workers' compensation claims that were ceded to Erieview over multiple years. Claims for reinsurance were made to Erieview, and payments of approximately \$32,000 and \$98,000 have been received on these claims during fiscal years 2017 and 2016, respectively. Reinsurance receivable from Erieview is estimated at approximately \$592,000 and \$645,000 at June 30, 2017 and 2016, respectively.

At June 30, 2017 and 2016, the estimated gross claims liability for National Steel recorded by the Fund is approximately \$9,028,000 and \$9,857,000, respectively.

Activity in the estimated liability for incurred, incurred but unreported, and incomplete claims for the years ended June 30, 2017 and 2016, is summarized as follows (rounded to the nearest thousand dollars):

	2017	2016
Balance, beginning	\$ 13,421,000	\$ 13,284,000
Less reinsurance receivable at July 1	(8,279,000)	(7,833,000)
	5,142,000	5,451,000
Change in actuarial estimates over prior-year estimates	81,000	(1,000)
Claims paid (net of reinsurance and subrogation proceeds of \$457,000 and \$406,000 in 2017 and 2016, respectively) related to member bankruptcies	(713,000)	(308,000)
	4,510,000	5,142,000
Plus reinsurance receivable at June 30	8,107,000	8,279,000
Balance, ending	<u>\$ 12,617,000</u>	<u>\$ 13,421,000</u>

At June 30, 2017, the Fund has recorded the actuary's estimate of the liabilities it has assumed from its bankrupt or insolvent members at the undiscounted amount of approximately \$12,617,000. If the liabilities were discounted using a 2.5 percent rate, the liabilities would approximate \$10,149,000.

During each of the fiscal years 2009 and 2015 as well as subsequent to these financial statements in fiscal year 2018, separate members filed for bankruptcy protection. As of the date of this report, these members have not defaulted on their workers' compensation liabilities. The Fund and the Department of Commerce are monitoring these situations, and the Fund has retained special bankruptcy counsel. No liability was recorded as of June 30, 2017, as the Minnesota Department of Commerce has not determined at this time that the Fund will be responsible for these workers' compensation claims. As of June 30, 2017, the Fund has not been notified of any members that had defaulted on their workers' compensation liability.

The Minnesota Self-Insurers' Security Fund

Notes to Financial Statements

Note 3. Member Liabilities Assumed (Continued)

It is possible that other members may become bankrupt or insolvent in the future. The number and amount of such future liabilities that the Fund may be required to assume, if any, cannot be estimated and, accordingly, no provision for such liabilities, if any, has been made in the financial statements.

Note 4. Security Deposits Receivable and Revenue

When the Fund assumes the workers' compensation liabilities for a bankrupt or insolvent member, it receives the posted security deposit that the Commissioner is holding. The Fund recognizes the security deposit as revenue when the Commissioner notifies the Fund that the member has defaulted on its workers' compensation claims and orders the Fund to pay the member's claims. Security deposits received in excess of the actuarially determined claims liability assumed are recorded as a liability on the balance sheets. When excess security deposits are received, subsequent changes in the estimate of claims liability assumed may cause increases or decreases in revenue.

In connection with the RisComp Industries, Inc. (RisComp) bankruptcy that occurred in 2002, RisComp posted a surety bond of \$2,996,000. The surety company exercised its option under Minnesota Statutes to administer and pay RisComp's workers' compensation benefits. In 2002, the Fund recorded the estimated liability assumed from RisComp and recognized the full amount of the surety bond as a receivable and as revenue. As the claims and professional fees are paid, the liability and receivable are decreased. At June 30, 2017 and 2016, the receivable was approximately \$106,000 and \$196,000, respectively, and the estimated remaining claims liability, net of reinsurance recoveries, was approximately \$113,000 and \$196,000, respectively. In the case that the estimated claims liability increases, approximately \$99,000 in additional security deposit would be available to pay these claims. No other security deposits receivable or revenue was recorded as of and for the years ended June 30, 2017 and 2016.

The receivable from the surety company is subject to the risk that the surety company may be unable or unwilling to pay claims in the future.

Note 5. Funding Policy and Subsequent Events

The Fund's primary source of revenue with which to pay liabilities that it has assumed from its bankrupt or insolvent members is the security deposit, which has been posted with the Minnesota Department of Commerce. The Fund also receives revenue from a terminating member assessment that is levied on any member when they no longer self-insure. In the event that revenue is inadequate to pay claims, the Fund may assess all members to make up the deficiency. The Fund recognizes the revenue from the bankrupt or insolvent member's security deposit when it is notified by the Commissioner and records the estimated liabilities that it has assumed from its bankrupt or insolvent members (see Note 3) when those liabilities are known. The Fund does not recognize the revenue that will be received from future members' assessments, which will be used to retire any excess liabilities, until the assessments are actually made to the members. The Fund's policy is to assess its members (within limits provided by state of Minnesota statutes) only when an amount is necessary to meet the annual cash flow requirements of the Fund if other sources of revenue are inadequate to pay claims and operating expenses for that year. A history of member assessments may be obtained on the internet at www.mnsisf.org.

In July 2017, the Fund made a 3 percent assessment to the members for approximately \$1,389,000.

In October 2017, a bankruptcy of a former member was reported to the Fund. The Minnesota Department of Labor and Industry has indicated that there are no open claims related to this member.

