



Audit of Municipal and Nonprofit Risk Pools December 2011

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Overview

Our Office annually audits (RCW 43.09.260) the financial statements and related schedules to ensure insurance risk pools are reporting properly. Additionally, we perform an Accountability Audit of the pools to assess internal controls and systems designed to safeguard public resources and to ensure compliance with state law.

More than 1,500 local governments statewide rely on risk pools for their insurance needs.

Audit Approach

We consider the following risks during our audits of the pools:

- The financial failure of a risk pool, resulting in insurance liabilities not being covered and financial implications for local governments statewide.
- Inadequate reserves to pay claims, requiring pools to perform reassessments of their members.
- Inaccurate and unreliable financial reporting, giving members and investors an inaccurate picture of pool operations and basis for making decisions.

We audit 17 risk pools annually. We conducted the fiscal year 2010 audits after the end of each pool's fiscal year end, which varies. Considering the above risks and prior audit results, we focused on the following:

- **Solvency** is a financial statement issue and a legal compliance issue. In general terms, solvency is an entity's ability to continue operations. We look at a pool's solvency to determine whether it complies with the standards for solvency that are outlined in Washington Administrative Code. All joint self-insurance pools need to obtain an annual independent actuary review as of the year end which provides estimates of the unpaid claims measured at 70 percent confidence level. Confidence level is the additional amount of funding necessary to provide confidence that the accrued funds will be adequate to meet future liabilities. The actuary will compute probabilities of funds at a 70 percent probability there will be enough money to pay off all future claims. We rely on the estimates of the pools' actuaries and use their actuarial studies in our assessment of solvency.
- **Financial reporting** is required annually. The pools must submit financial reports to the State Auditor's Office within 150 days after their fiscal year end (RCW 43.09.230). A financial audit must be completed and the final audit report submitted to the state division of Risk Management at the Department of Enterprise Services within one year of the pool's fiscal year end (WAC 82.60.037).

Audit Results

We identified the following audit concerns in the past three years:

Solvency

1. In a 2010 audit, we added information to our financial audit report to identify a pool that was operating in an unsafe financial condition due to the level of claims paid and accrued and an insufficient amount of member premiums collected.
2. In a 2009 audit, we reported a pool voted to terminate its medical insurance plan due to inadequate funds at the end of 2010. It has remained in operation at a reduced capacity.
3. In 2008 audits, we reported two pools were not disclosing all actuarial evaluations of their Incurred But Not Reported liability, a measure of future insurance claims against the fund and a \$594,059 liability for a premium deficiency. We qualified our financial opinions as a result of this omission.

Lack of board oversight of accounting and financial reporting

4. In 2010, four audits identified concerns with unauthorized financial activities occurring without board knowledge or approval. We also found a lack of monthly monitoring of the pools' bank accounts.
5. One 2010 audit identified a significant omission in a pool's financial reporting, resulting in delayed completion of the audit, which further resulted in noncompliance with state regulations (WAC 82.60.037) and delayed access by users of the financial information.
6. In 2009, five audits identified concerns with the accuracy and timeliness of financial information reported by pools. Completion of the audits were delayed due to multiple revisions of the financial statements, resulting in noncompliance with state law and regulations (RCW 43.09.230 and WAC 82.60.037) and delayed access by the users of the pools' financial information. We attributed the errors and untimely financial reporting to the governing boards' lack of oversight of the third-party administrator responsible for accounting and reporting.
7. In 2008, four audits identified concerns with the accuracy of pools' reported financial information. We found financial information was inaccurate, omitted, incomplete or not adequately supported. The errors were attributed to the governing boards' or managements' lack of oversight of the third-party administrator responsible for accounting and reporting.

Non-compliance with state law and regulations

8. In a 2010 audit, we reported a pool exceeded its authority when transferring funds to an organization whose purpose was to provide risk pooling to out-of-state nonprofit organizations.
9. In 2008, two audits reported the risk pools had investments that were not authorized by state law.

The following table depicts our audit results:

Fiscal periods vary for the pools below and are documented following their names. State law requires all risk pools to receive an annual financial statement audit. The numbers in the years listed below correspond with the issues noted on page two of this report as audit issues. If nothing is noted in a year column next to an entity, it means no significant issues were reported.

Risk Pool Name-fiscal year end	2008	2009	2010
Central Washington Public Utilities Unified Insurance Program Trust*-July 31			
Cities Insurance Association of Washington* - August 31	7 [^]	6 [^]	1,4 [#]
Enduris Washington –August 31			
Non Profit Insurance Program-May 31		6 [^]	5,8 [#]
Public Utility Risk Management Services Joint Self-Insurance Fund*-December 31			
Schools Insurance Association of Washington*- August 31		6 [^]	4 [#]
United Schools Insurance Program*-August 31	7 [^]	6 [^]	4 [#]
Washington Cities Insurance Authority-December 31			
Washington Cities Risk Management Service Agency Association of – December 31			
Washington Counties Insurance Fund*- December 31	3,7,9 [@]		
Washington Counties Insurance Pool*-December 31	3,7,9 [@]	2 [#]	
Washington Rural Counties Insurance Pool*- August 31		6 [^]	4 [#]
Washington Schools Risk Management Pool- August 31			
Washington State Transit Insurance Pool- December 31			
Water and Sewer Risk Management Pool*- October 31			
Washington Counties Risk Pool-September 30			
Housing Authority Risk Retention Pool (new to audit in 2010)*-December 31			

Footnotes to table:

- * Third party administrators used to manage operations
- [^] Issues cited in the finding are considered partially resolved.
- [#] The status of these issues will be evaluated during our next audit.
- [@] Issues reported in the finding are considered resolved.

Supplemental Information on Municipal and Nonprofit Risk Pools

What are risk pools?

A risk pool is a legal entity composed of municipalities and/or nonprofit corporations that have joined to finance an exposure, liability or risk. The financing mechanism may be group purchase or group self-funding, a combination of the two, or other cooperative financing means for primary and/or excess coverage. Risk pools are funded by member assessments or contributions, insurance reimbursements and interest on reserve funds.

In authorizing risk pools, the state Legislature intends to provide maximum flexibility in self-insuring in a safe and sound manner. State law provides the authority for municipal and nonprofit corporation self-insurance programs.

Local governments are authorized to individually and/or jointly:

- Self-insure.
- Purchase insurance or reinsurance.
- Contract for risk management, claims and administrative services.

Under the law, nonprofits may form or join a self-insurance risk pool with one or more nonprofits or with a local government entity or entities for property and liability risks.

Local governments and nonprofit corporations come under the regulatory authority of the state risk manager, who is part of the new Department of Enterprise Services. State law requires approval for health and welfare and joint property and liability insurance pools prior to creation. Additionally the risk manager must approve all self-insurance programs for health and welfare and property and liability for local entities.

State law regarding risk pools may be found at Chapter 48.62 Revised Code of Washington and Chapters 82-60 and 82-65 of the Washington Administrative Code. The authority of the State Auditor's Office is found at Chapter 43.09 RCW.

What is the role of the local government entity governing body and the nonprofit board of directors related to the administration of risk pools?

The risk pool board creates the pool and institutes policies and procedures to ensure strong oversight of pool operations and compliance with state law and regulations. It also is responsible for responding to audit findings.

Washington Administrative Code 82-60-020(12) and 82-60-020(13) state: "*Governing body*" means *the multimember board, commission, committee, council, or other policy or rule-making body of a public agency, or any committee thereof when the committee acts on behalf of the governing body, conducts hearings, or takes testimony or public comment.*

The WACs do not clearly detail what kind of monitoring the boards are expected to do, even though they ultimately are responsible for ensuring compliance with all standards necessary for operating the pool; for policy-making; and for plan management. Some of the pools' boards rely heavily on third-party administrators to oversee management and day-to-day operations.

What is the role of the state risk manager as it relates to the administration of municipal and nonprofit risk pools?

The State Risk Manager in the new Department of Enterprise Services approves the initial charters and contractual provisions for the pools and any significant changes to how they are operated (RCW 48.62.061). The Risk Manager also writes the rules and standards governing pool management. The Program Administrator for Local Government Risk Pools, within the Risk Management Office, has an ongoing regulatory role for the pools (Chapters 82-60 and 82-65 of the Washington Administrative Code).

How does audit resolution work?

Audit resolution is the responsibility of the governing body or board of directors of the pools. The State Risk Manager's Program Administrator over Local Government Risk Pools receives copies of our reports and monitors their compliance. The State Auditor's Office maintains close contact with the Risk Manager's Office regarding issues of concern.

Further, the State Auditor's Office provides copies of reports disclosing noncompliance or malfeasance, misfeasance or nonfeasance in office on the part of any public officer or employee to the Attorney General's Office as required by RCW 43.09.260 (6). In the case of malfeasance, misfeasance, or nonfeasance in office, the Attorney General is obligated to pursue legal action as a civil matter.

What is unique about risk pool financial reporting?

Risk pools are required to report under Generally Accepted Accounting Principles (GAAP) as defined in the Annual Financial Reporting Package for Public Entity Risk Pools issued by the Washington State Auditor's Office.

The current statutory timeline for annual financial reporting to the State Auditor's Office (RCW 43.09.230) is 150 days after their fiscal year end.

Within the annual reporting package the risk pool is also required to prepare and submit supplemental schedules required by the division of Risk Management at Department of Enterprise Services. Those schedules include a Ten-year Claimed Development Information, Reconciliation of Claims Liability by Type of Contract, List of Participating Members and the Schedule of Expense.

During our audits we examine, among other things, whether the pools have properly reported the following items on their balance sheet:

- Claims reserve-current. Estimated cost of resolving claims made in the current year.
- Claims reserve-prior. Estimated cost of resolving claims made in the prior years.
- Incurred But Not Reported (IBNR). Current accounts for estimated claims that have not been incurred during the current year but have not yet been claimed to the pool.
- IBNR-Prior. This liability accounts for estimated claims that have been incurred during the prior year but have not yet been reported or claimed by the pool. Claimants can have up to 10 years to file a claim.
- Unallocated Loss Adjustment Expense. The liability is for the estimated costs of administering current claims and estimated unreported claims.