

Self Insurance Group Annual Financial Statement Reporting Requirements

The purpose of this letter is to provide guidance to Self-Insured Group (SIG) Boards of Trustees, Group Administrators, and independent auditors related to the preparation of the annual audited financial statements submitted to the Office of Self-Insurance Plans (OSIP). SIGs operating in California are required to annually obtain an independent audit of the SIG's financial statement as of the end of the SIG's fiscal year. The financial statements are used to: 1) monitor the financial health of SIGs; 2) determine compliance with regulatory funding requirements for the group's aggregate results; 3) establish eligibility for the declaration and payment of surplus distributions; 4) determine the need for corrective action plans; and 5) review for compliance with certain rules and regulations. In addition, the financial statements serve to inform and guide decision-making on the part of all interested stakeholders including the Board of Trustees, affiliate members, the administrator and OSIP.

To ensure that reports are compliant with the rules and regulations and that they also meet the specific needs of OSIP, the following presents a summary of the relevant regulatory requirements for independently audited financial statements submitted to OSIP.

The California Code of Regulations (CCR) sets forth the specific compliance requirements for the preparation and submission of audited financial statements and is available on the OSIP website under Regulations (<http://www.dir.ca.gov/sip/sip.html>). CCR § 15475 (d) (5) requires that the Board of Trustees of a SIG obtain an independent audit of the SIG's financial statements immediately after the completion of the SIG's year end. CCR § 15484 sets forth the specific compliance requirements for the preparation and submission of financial statements and contains the following requirements:

- Interim financial statements must be submitted to OSIP by March 1st of each year;
- Audited financial statements must be prepared in accordance with Generally Accepted Accounting Principles (GAAP) and be complete with all footnote disclosures and required schedules; and
- Audited financial statements must be submitted to OSIP by July 1st following the SIG's program year end.

In addition, CCR § 15484 requires the audited financial statements specifically report the amounts collected from member contributions, earnings from investments, and the following administrative expenses:

- Fees and commissions paid to the Group Administrator
- Commissions paid to brokers;
- Fees paid to the third party administrator;
- Premium paid for excess insurance;

- Premium paid for fidelity and errors and omissions coverage;
- Fees paid for surety bonds, letters of credit, or any other security deposit related cost;
- Fees paid to actuaries;
- Fees paid to accountants;
- Regulatory costs; and
- Taxes

In addition to the regulatory requirements described above, SIGs should ensure the audited financial statements submitted to OSIP are complete and include the presentation and footnote disclosures unique to insurance entities. SIGs are encouraged to consult with their independent auditors on the preparation of financial statements and to seek resources such as *The American Institute of Certified Public Accountant's Audit and Accounting Guide for Property and Liability Insurance Entities* which provides accounting and auditing guidance, as well as illustrative financial statements and footnote disclosures for insurance enterprises.

OSIP recommends at a minimum that the following information be included in SIG audited financial statements and accompanying footnote disclosures submitted to OSIP. This is not an exhaustive list and SIGs should consult with their auditors to ensure that all required disclosures are included in the financial statements.

1. Nature of SIG Operations

SIGs should provide disclosures about the nature of the SIG's operations to provide the reader with a thorough understanding of the structure and operations of the SIG. Those disclosures must include, but are not limited to the following:

- Formation, membership information, and admission and withdrawal provisions;
- Nature of self-insurance arrangement, self-insured retention, etc.;
- Aggregate and specific excess insurance coverage information; and
- Governance and administration.

2. Liability for Unpaid Loss and Loss Adjustment Expenses (Loss and LAE)

The liability for unpaid loss and LAE (including unallocated loss adjustment expenses, or "ULAE") liabilities should be recorded in accordance with GAAP, which OSIP believes to be the actuarially determined "expected confidence level" or "central estimate."

3. Discounting Liability for Unpaid Loss and LAE to Net Present Value

If SIGs choose to discount their liability for unpaid loss and LAE, the interest rate assumption must be disclosed in the footnotes as well as the undiscounted and discounted liabilities for unpaid loss and loss adjustment expenses.

4. Liability for Unallocated Loss Adjustment Expenses (ULAE)

Record an actuarially-determined liability for ULAE in accordance with GAAP.

5. Reconciliation of the Liability for Unpaid Loss and Loss Adjustment Expenses

Include the following reconciliation of the liability for unpaid loss and LAE as a footnote disclosure.

	<u>20XX</u>	<u>20XX</u>
Gross liability for unpaid loss and loss adjustment expenses at beginning of year		
Less reinsurance recoverable		
Net liability for unpaid loss and loss adjustment expenses		
 Incurred loss and loss adjustment expenses:		
Provision for insured events of the current fiscal year		
Change in provision for insured events of prior fiscal years		
Total incurred loss and loss adjustment expenses		
 Payments:		
Loss and loss adjustment expenses attributable to insured events of the current fiscal year		
Loss and loss adjustment expenses attributable to insured events of prior fiscal years		
Total payments		
 Net liability for unpaid loss and loss adjustment expenses at end of year		
Plus reinsurance recoverable		
Gross liability for unpaid loss and loss adjustment expenses		
 Components of unpaid claims and claim adjustment expenses:		
Known claims		
Claims incurred but not reported		
Unallocated loss adjustment expenses		
Total		

6. Ultimate Losses and Liability for Unpaid Losses by Accident Year

Disclose the following information on the losses by accident year. The ultimate losses should agree to the actuarial report submitted to OSIP and should include all years since the SIG’s inception.

Claim Year	Ultimate Loss per Actuary at Expected Confidence Level	Less: Claims Payments	Less: Reserve for Known Claims	Incurred But Not Reported	“Memo” Unpaid Loss & ALAE at Expected Confidence
20XX					
20XX					
20XX					
20XX					
Total, undiscounted					
Less: Adjustment for net present value					
Total, discounted					

7. Reinsurance Receivables and Recoverables

Record estimated receivables and recoverables from aggregate and specific excess insurance carriers as assets in accordance with GAAP.

8. Cash and Cash Equivalents

Uninsured cash and cash equivalents should be disclosed in the footnote disclosures.

9. Investments

The following minimum disclosures should be made regarding investments:

- Type of security;
- Credit rating from a nationally recognized statistical ratings organization;
- Fair market value;
- Amortized cost;
- Unrealized gain or loss;
- Maturity information (within one year, between one and two years, between two and five years, and

beyond five years)

10. Security Deposits

SIGs should disclose the type and amount of all security deposits posted with OSIP, as well as any SIG assets pledged to support those instruments.

11. Regulatory Surplus or Deficit

SIGs should provide a supplemental schedule or footnote disclosure in the audited financial statements showing the regulatory surplus or deficit with unpaid losses and LAE stated at the expected confidence level using the following format.

	<u>20XX</u>	<u>20XX</u>
Ending audited Member’s equity (deficit)		
Less: adjustment to achieve an actuarially-determined expected confidence level for:		
Unpaid loss and allocated loss adjustment expenses		
Unpaid unallocated loss adjustment expenses		
Total additional liabilities	_____	_____
Regulatory surplus (deficit)	=====	=====