

## 2015 FUNCTIONAL AND PROGRESS REPORT

The Injured Patients and Families Compensation Fund (Fund) was created in 1975 to provide medical malpractice insurance for Wisconsin health care providers in excess of the provider's primary limits of coverage. The Fund provides coverage in excess of the primary limit established by statute, which is currently \$1 million per occurrence and \$3 million aggregate per year. Participation in the Fund is mandatory for health care providers as defined by Chapter 655, Wis. Stat.

The Fund is governed by a 13-member Board of Governors (Board) which consists of 3 insurance industry representatives, a member named by the Wisconsin Association for Justice, a member named by the State Bar of Wisconsin, 2 members named by the Wisconsin Medical Society, a member named by the Wisconsin Hospital Association, 4 public members appointed by the Governor, and the Commissioner of Insurance, who serves as the chair.

Members of the Board during 2015 were:

Theodore K. Nickel, Commissioner of Insurance  
Marty Arnold, Industry Representative  
Gregory Banaszynski, Public Member  
Carla Borda, Public Member  
M. Angela Dentice, Wisconsin Association for Justice  
Susan Engler, Public Member  
Robert Jaeger, M.D., Wisconsin Medical Society  
David Maurer, Industry Representative  
Linda Syth, Wisconsin Medical Society  
Ralph Topinka, Wisconsin Hospital Association  
John Walsh, State Bar of Wisconsin  
Vacant, Industry Representative  
Vacant, Public Member

The Fund's Board is assisted in its governance function by the following: an Actuarial and Underwriting Committee, a Legal Committee, a Claims Committee, a Finance/Investment/Audit Committee, a Risk Management and Patient Safety Committee, and a Peer Review Council. The Board and committees generally meet at least quarterly.

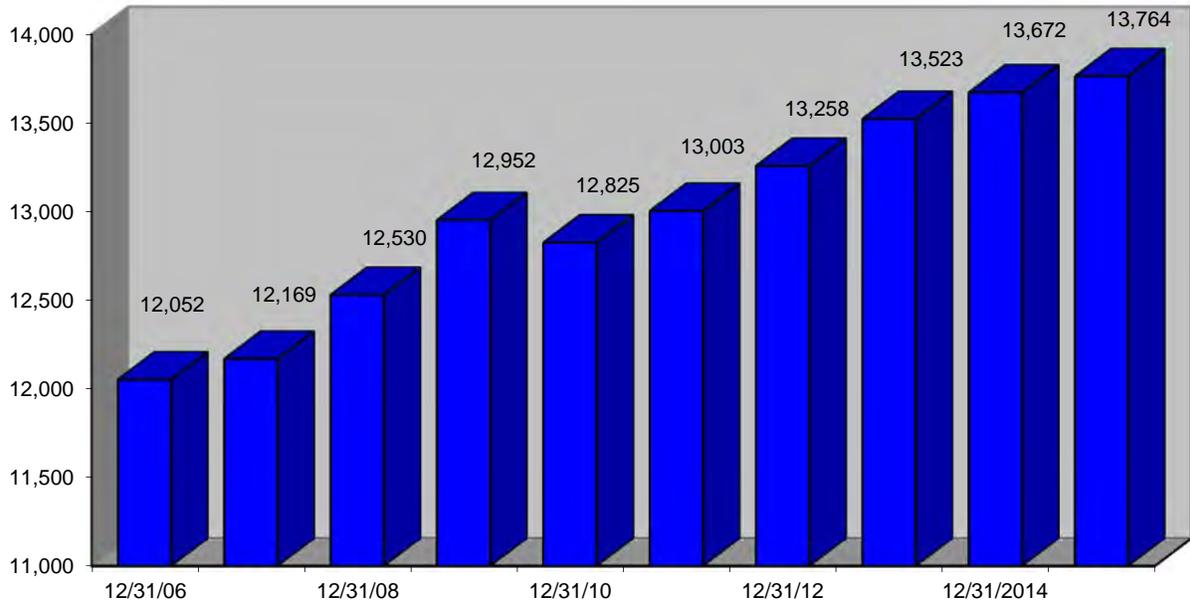
The Fund operates on a fiscal year basis: July 1 through June 30. Administrative costs, operating costs, and claim payments are funded through assessments on participating health care providers.

### Fund Participants

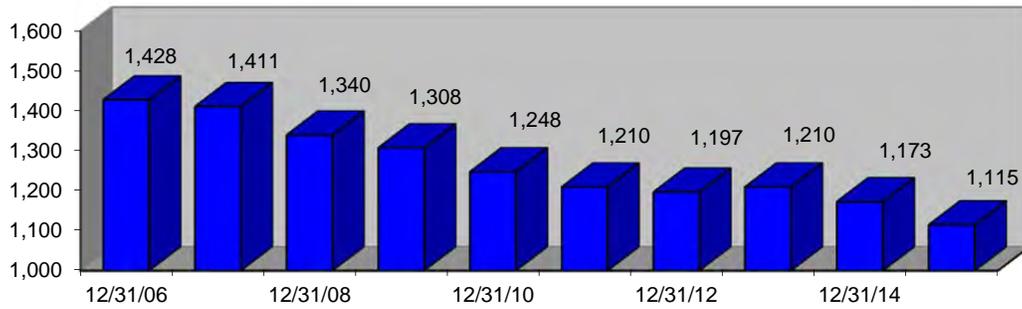
As of December 31, 2015, there were a total of 15,873 Fund participants comprised of 129 hospitals with 14 affiliated nursing homes, 13,764 physicians, 745 nurse anesthetists, 19 hospital-owned or controlled entities, 67 ambulatory surgery centers, 1 cooperative, 19 partnerships, and 1,115 corporations actively participating in the Fund.

As of December 31, 2015, physicians comprised 87% of the Fund participants, and corporations made up 7%. All other participants made up the remaining 6%.

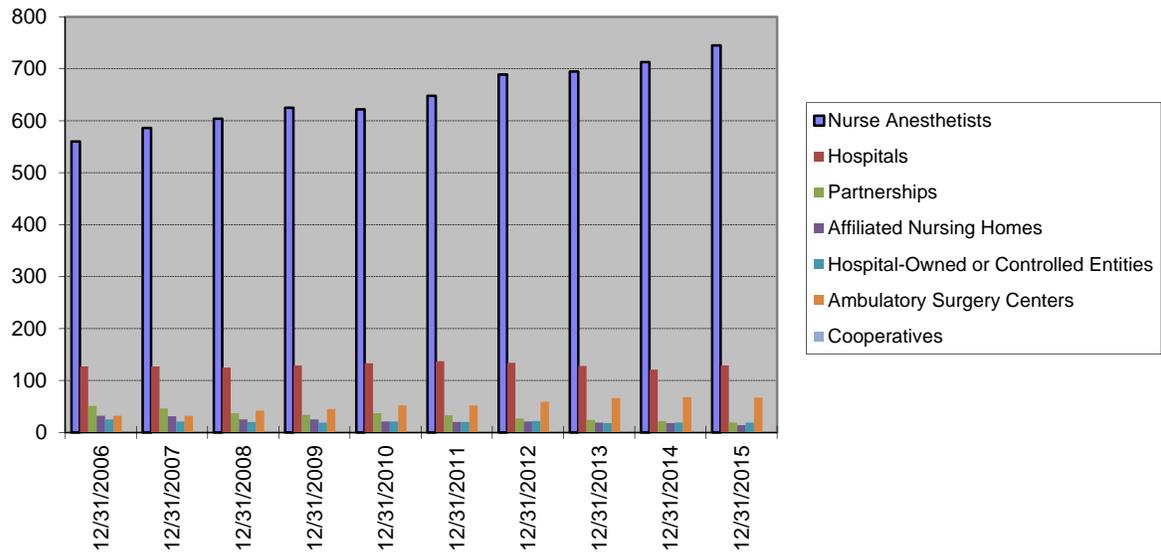
**Physicians in Injured Patients and Families Compensation Fund  
2006-2015**



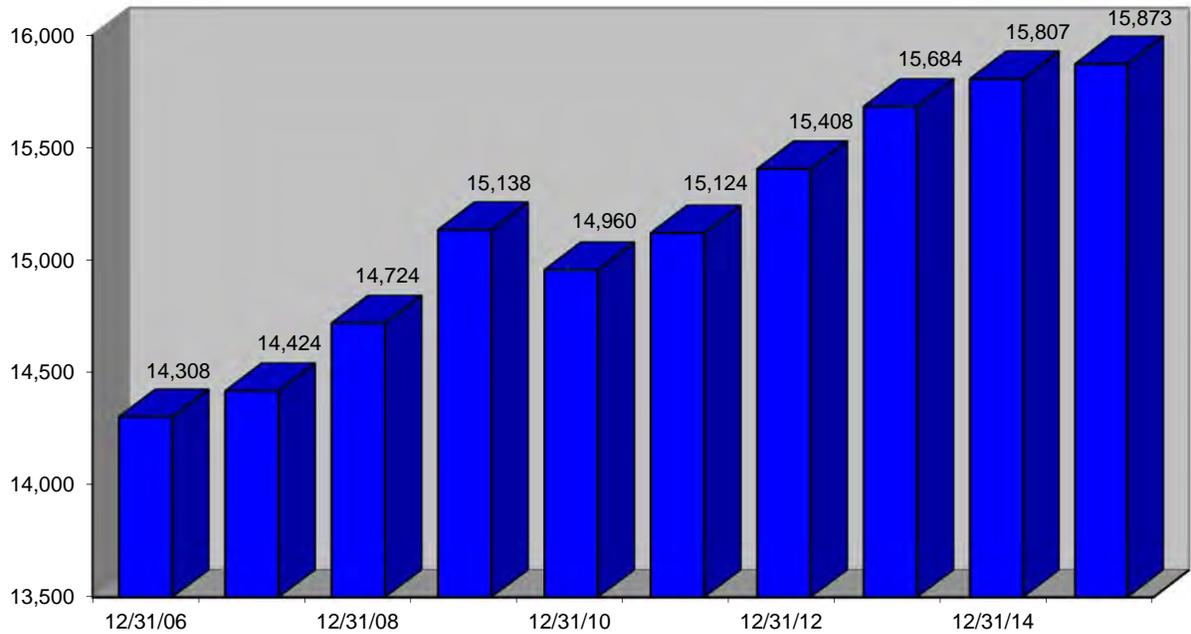
**Corporations in Injured Patients and Families Compensation Fund  
2006-2015**



### Other Participants in Injured Patients and Families Compensation Fund 2006-2015



### Injured Patients and Families Compensation Fund Participants 2006-2015



## **Claims Activity**

From July 1, 1975, through December 31, 2015, 6,036 claims had been filed in which the Fund was named. During this period, the Fund's total number of paid claims was 668, totaling \$861,555,840. Of the total number of claims in which the Fund has been named, 5,228 claims have been closed with no indemnity payment.

## **Board Committees**

### *Actuarial and Underwriting Committee*

The Actuarial and Underwriting Committee advises the Board on actuarial and underwriting issues.

The Committee assisted the Board to promulgate the Fund Fee Rule for fiscal year 2015-2016 fees. There was a 34% decrease in total fees for fiscal year 2015-2016. Mediation panel fees for physicians (excluding physicians in a residency program) were set at \$13.50 per physician and \$2.75 per occupied hospital bed.

### *Claims Committee*

The responsibility of the Claims Committee of the Board is to establish claims policies and procedures for the Fund and the Wisconsin Health Care Liability Insurance Plan (Plan).

The functions of the Claims Committee include the following:

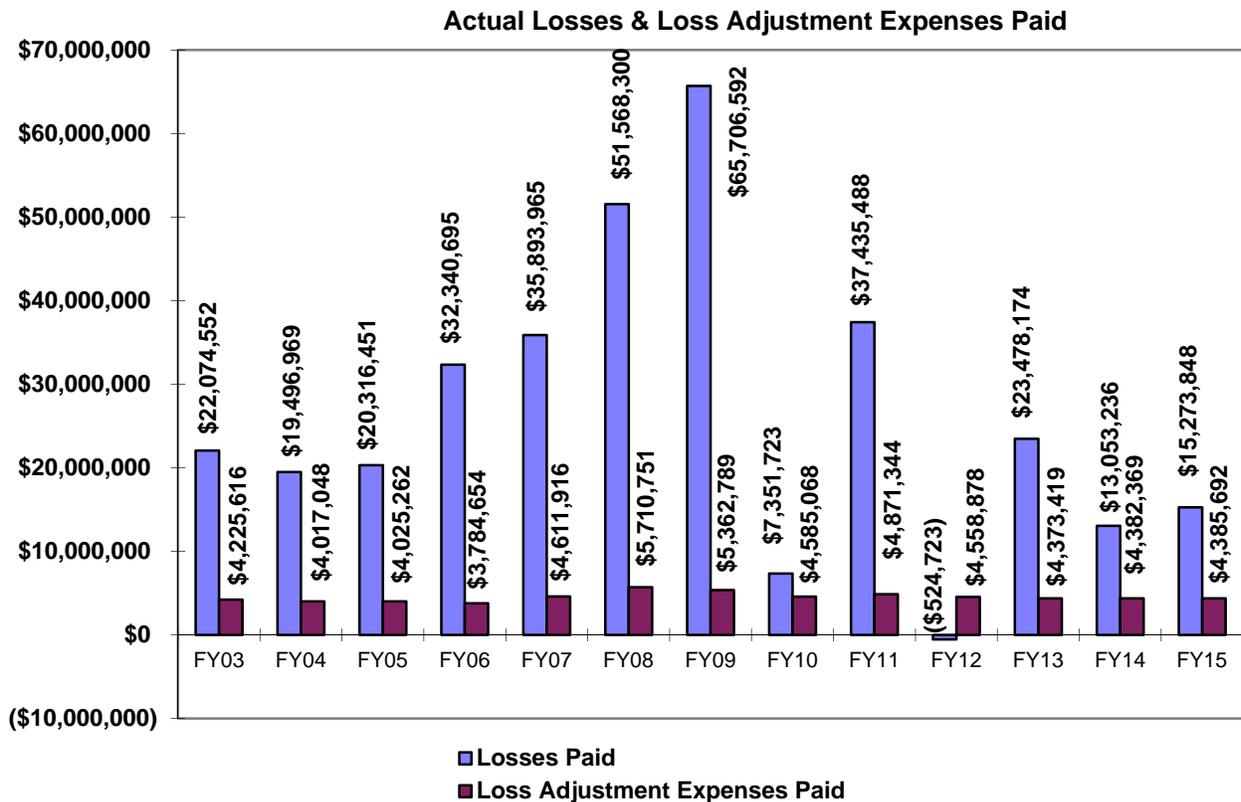
- Establish guidelines for claims management by the contractor and Office of the Commissioner of Insurance (OCI) staff of the Fund and the Plan and review claims to determine if the guidelines need to be revised.
- Provide for the evaluation of the claims contractor no less often than prior to the renegotiation of each contract to assure that claims are being handled in an appropriate and expeditious manner.
- Review all claims involving alleged sexual misconduct, neurological impairment, quadriplegia, and those claims which the contractor has set reserves of \$500,000 or more, and provide settlement authorization and advise on those claims where settlement value exceeds \$1 million or when the contractor has a claim management question.
- Monitor claims administration costs and make recommendations for possible savings to the Board and the contractor.
- Establish guidelines for annuity purchases for structured settlements and review such purchases periodically. Recommend to the Board changes in the statutes or administrative rules that are needed to facilitate the claims policies and procedures of the Fund or Plan.
- Refer legal or other issues that come to the Committee's attention to the appropriate committees.
- Prepare reports analyzing claims trends for risk management purposes.
- Report to the Board quarterly on the Committee's activities.

Table 1 summarizes quarterly loss payments by amount and number of claims paid from fiscal 2011 through fiscal 2015. The Actual Losses and Loss Adjustment Expenses Paid chart shows the range of annual Fund loss and loss expense payments beginning with fiscal year 2003. The Fund's fiscal year runs from July 1 to June 30. The Fund reported loss payments totaling approximately \$15.3 million during fiscal 2015.

**Table 1**

**Amount and Number of Losses Paid by Fiscal Year**

Quarter Ending	2010-2011 Amount #	2011-2012 Amount #	2012-2013 Amount #	2013-2014 Amount #	2014-2015 Amount #
September 30	\$26,040,884 3	\$ 362,355 2	\$ 1,268,692 1	\$ 3,496,884 1	\$ 469,442 1
December 31	10,280,391 2	(228,203) 0	15,337,597 2	9,000,391 1	5,856,158 2
March 31	1,133,725 0	23,526 0	6,891,391 1	575,570 1	8,866,670 2
June 30	(19,512) 0	(682,401) 1	(19,506) 0	(19,609) 0	81,578 0
Total	<u>\$37,435,488</u> 5	<u>\$(524,723)</u> 3	<u>\$23,478,174</u> 4	<u>\$13,053,236</u> 3	<u>\$15,273,848</u> 5



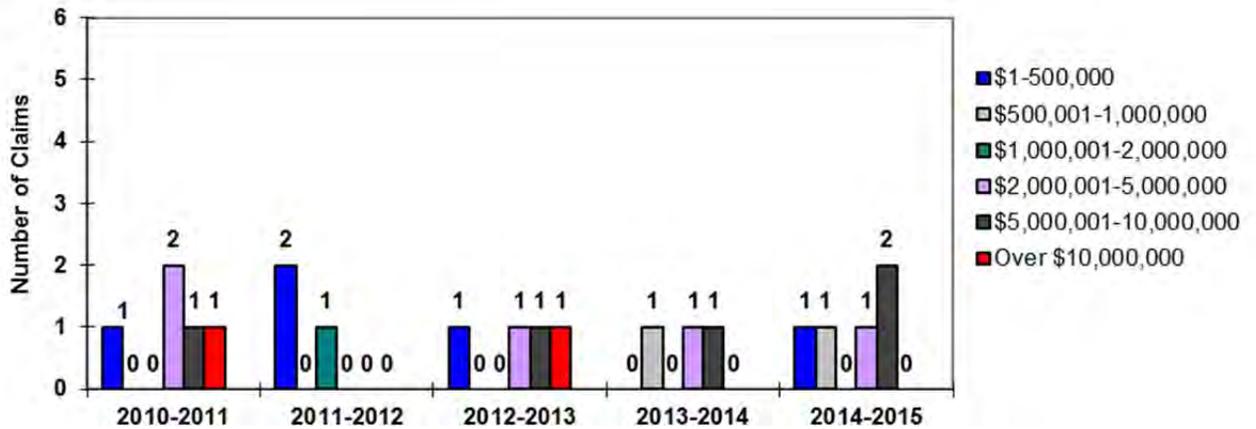
The range of Fund claim payments for the last five fiscal years is summarized below in Table 2.

**Table 2**

**Range of Fund Claim Payments**

	<b># of Claims 2010-2011</b>	<b># of Claims 2011-2012</b>	<b># of Claims 2012-2013</b>	<b># of Claims 2013-2014</b>	<b># of Claims 2014-2015</b>
\$1-500,000	1	2	1	0	1
\$500,001-1,000,000	0	0	0	1	1
\$1,000,001-2,000,000	0	1	0	0	0
\$2,000,001-5,000,000	2	0	1	1	1
\$5,000,001-10,000,000	1	0	1	1	2
Over \$10,000,000	<u>1</u>	<u>0</u>	<u>1</u>	<u>0</u>	<u>0</u>
<b>Total</b>	<u>5</u>	<u>3</u>	<u>4</u>	<u>3</u>	<u>5</u>

**Range of Claim Payments**



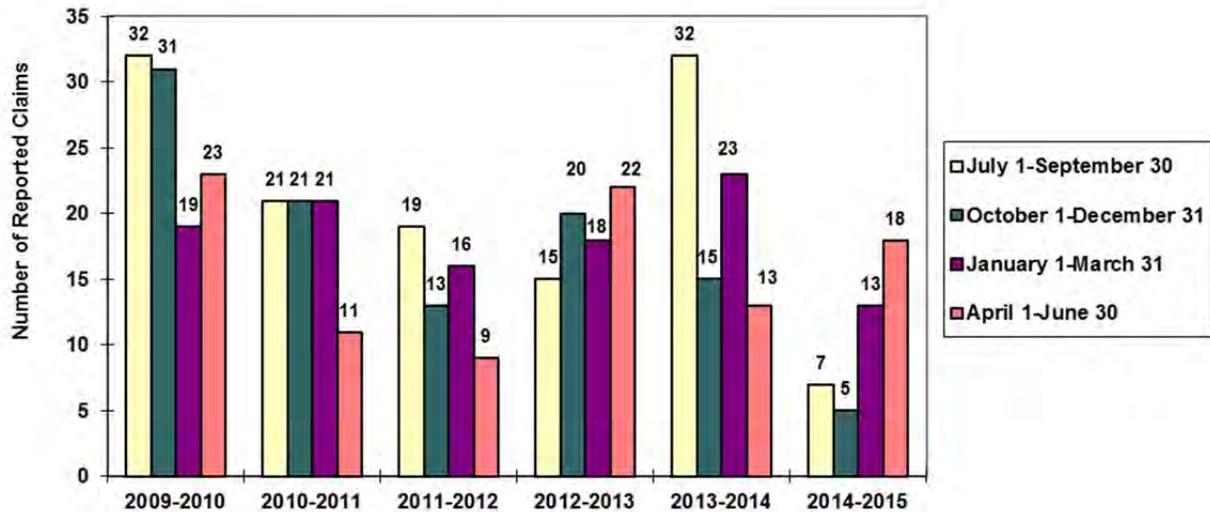
Fund claims reported by quarter by fiscal year are summarized in Table 3 below. A total of 43 claims were opened during fiscal 2015.

**Table 3**

**Claims Opened Quarterly by Fiscal Year**

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
July 1-September 30	21	19	15	32	7
October 1-December 31	21	13	20	15	5
January 1-March 31	21	16	18	23	13
April 1-June 30	<u>11</u>	<u>9</u>	<u>22</u>	<u>13</u>	<u>18</u>
	<u>74</u>	<u>57</u>	<u>75</u>	<u>83</u>	<u>43</u>

**Claims Reported by Quarter by Fiscal Year**



*Finance/Investment/Audit Committee*

The Finance/Investment/Audit Committee’s responsibilities include establishing, monitoring, and amending as necessary, the investment strategy for the Fund to ensure obligations are met. The Committee periodically reviews investments for compliance with investment guidelines and evaluates cash flow liquidity needs. In addition, the Committee oversees the financial reporting process. Responsibilities include review of financial position and results, as well as correspondence with auditors concerning audit scope, accounting issues, internal controls and management recommendations.

### *Legal Committee*

The Legal Committee advises the Board on legal issues, including retroactive coverage requests, appeals, proposed statutory changes, administrative rule changes, and other issues that affect eligibility or Fund participation.

During 2015, the Committee reviewed 281 requests for retroactive coverage of which 264 were approved, 1 was denied, and 16 were deferred pending receipt of further information.

### *Peer Review Council*

The Peer Review Council (Council) reviews physician claim records to determine whether a surcharge should be imposed against the Fund fee or Plan premium, if applicable. The surcharge is a percentage of a provider's Fund fee or Plan premium based on the number of closed medical liability claims reported and the aggregate amount paid for those claims.

During the fiscal year from July 1, 2014, to June 30, 2015, 128 claims paid reports were filed. These included 40 for physicians or nurse anesthetists, 78 for hospitals, nursing homes, corporations or clinics, and 10 for other types of providers. Two providers were subject to possible surcharge.

Since inception of the Council in 1986, 67 providers have been subject to possible surcharge. The status, or disposition, of those providers as of June 30, 2015, was as follows:

- Exemptions from participation in the Fund have been filed by 35 providers, resulting in suspension of the review for surcharge.
- No surcharge was warranted for 12 providers as a result of the Council's review or consultant opinions.
- Two providers have been surcharged for failure to respond to Council requests for information.
- The review for surcharge was pending for two providers.

### *Risk Management and Patient Safety Committee*

The purpose of the Risk Management and Patient Safety Committee, created in June 1991, is to reduce patient/claimant compensable injuries, reduce Fund losses and associated expenses, improve the general quality of medical care, and reduce the premiums of participating health care providers.

Activities of the committee during 2015 included the following:

- Publication of the risk management newsletter, *WiscRisk*, also available on the Fund Web site: <http://oci.wi.gov/ipfcf/bulletins.htm>
  - *Health Literacy Impacts What You Do Every Day*
  - *Wisconsin Injured Patients and Families Compensation Fund 101*
- Production and distribution of the 2016 *Patient Safety Calendar* with specific monthly tips for improved communication among health care team members.

Also in 2015, the Committee continued its strategic initiatives based on purpose and areas of focus.

Committee purpose:

- Provide primary risk management services to the Plan.

- Provide secondary risk management services to the Fund (primary services being provided by primary carriers).
- A proactive risk management program would be provided through:
  - Review of risk management data.
  - Prioritization of loss prevention and risk reduction initiatives through establishment of specific goals.
  - Oversight of implementation and evaluation of effectiveness of those initiatives.

Proposed areas of focus:

For the Plan:

- Identify customers and services/specialty loss history.
- Survey needs.
- Develop product/service. Based on survey responses newsletter articles are targeted to topics of interest.
- Educate Plan customers about available risk management services. A flier highlighting risk management services available is distributed to Plan insureds by the Plan directly or through agents.

For the Fund:

- Survey large health care systems (potentially shifting paradigm from individual provider to enterprise risk management). Based upon 2015 telephone survey the Committee recommended rebranding the newsletter and calendar to clearly reflect that the Fund is the source of the communication.
- Education through facilitation of best practices (e.g., clearinghouse/case studies). *WiscRisk* newsletter and the *Patient Safety Calendar* included a list of resources specific to the topic at hand.
- Develop a communication plan. To provide *WiscRisk* newsletter to risk managers, the Wisconsin Society of Healthcare Risk Managers distributes an electronic copy to its members.

## **Other Fund Activities**

### *System Development*

The 2015 release of enhancements to the Web-based interface to the Fund system provides benefits to participants and staff by offering online availability of standard forms (Request for Exemption and Request for Retroactive Coverage). Of 5,000 Request for Exemption forms filed in 2015, 3,000 were completed electronically.

Participants benefit from forms prefilled with account-specific data, for example

- Name
- License
- Noncompliant periods

Administrative staff benefits from

- Accuracy of data
- Ease of entry/readability
- Capture of personal contact information

The 2015 enhancements are part of a series of ongoing releases of Fund system development initiated in 2010.

- Release of 2010 provided web-based interface for Fund system.
- Release of 2011 provided carriers and self-insurers secure access to download certificates.
- Release of 2012 allows the general public to search the database for participant coverage records and provides participants and employers secure access to paperless billing.
- Release of 2013 allows participants to make electronic payment and update certain account information.
- Release of 2014 improves processes for participants with secure access, allowing for updates of employee counts and outpatient visits online as well as receive electronic notice of noncompliance issues.

Continued development will incorporate further functionality for improved customer service.

Links to the public database and to secure log-in access are available on OCI's Fund Web page (<http://oci.wi.gov/ipfcf/sysaccess.htm>).

#### *Other Activities*

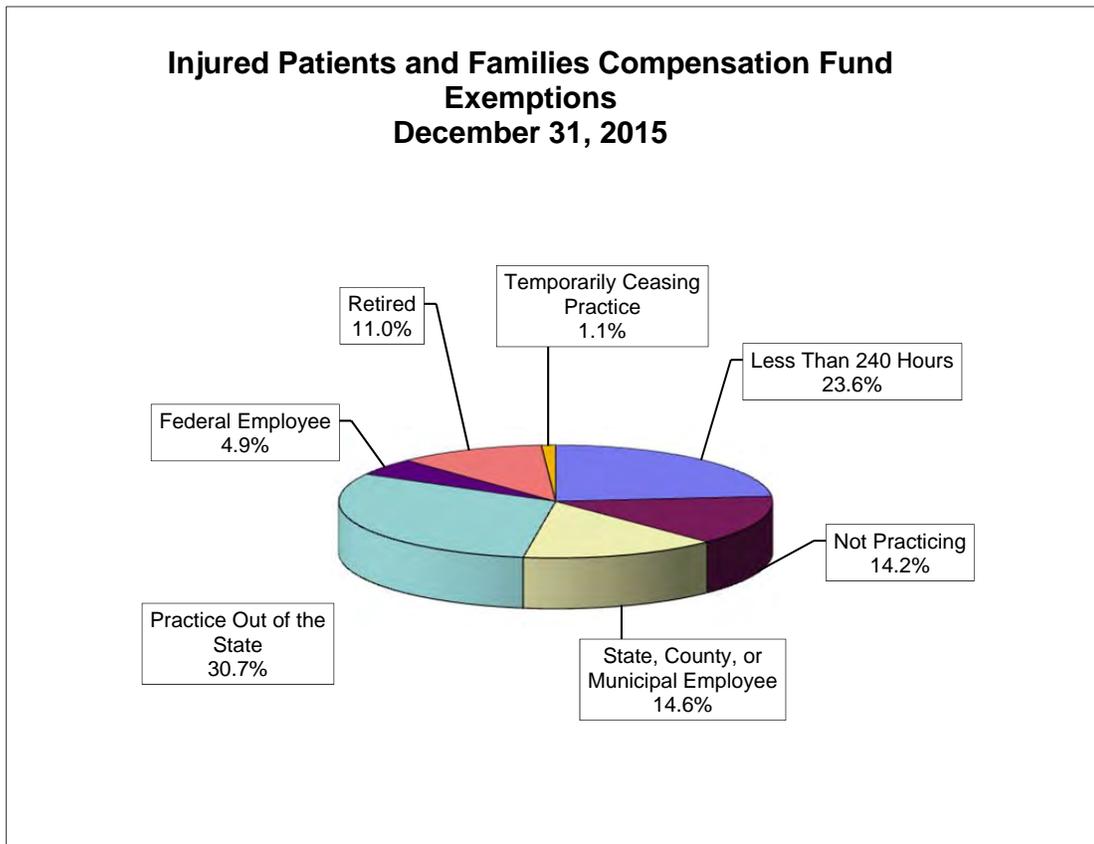
Fund administration closely monitors the use of outside counsel. Pursuant to a court decision in 2000, the Fund hires separate defense counsel on each claim. Fund staff monitors the claims and the use of outside counsel to ensure that, while the Fund receives the necessary representation, legal fees are controlled.

Pursuant to a Legislative Audit Bureau recommendation and a directive by the Board of Governors, an actuarial audit was performed in 2011 on the analysis performed in 2010 by the outside actuarial firm. This audit opinion concluded that the assumptions and methodologies used by the Fund's actuary and the risk margin of 25% established by the Board were reasonable. A recommendation was made to reduce the discount factor used to discount the claim liability reserves. Prior to the issuance of the audit report, the Board reduced the discount factor by .5%, to 5.0%, applicable to June 30, 2012, reserves. In 2012, the Board reduced the discount factor another .5%, to 4.5%, applicable to June 30, 2013, reserves and in 2015 the Board reduced the discount factor .5% to 4.0%, applicable to the June 30, 2014, reserves.

The Fund continually monitors and updates the exemption status for providers that held a license to practice in Wisconsin but for which a current exemption or certificate of insurance was not on file with the Fund. Providers that remain in noncompliance are referred to their respective licensing boards for appropriate enforcement action by that board.

As of December 31, 2015, there were 11,585 providers exempt from participation in the Fund. The exemptions are grouped as follows:

Practice Out of Wisconsin	3,553
Less Than 240 Hours	2,730
State, County, or Municipal Employee	1,697
Not Practicing or Never Practiced in Wisconsin	1,642
Retired	1,271
Federal Employee	569
Temporarily Ceasing Practice	123

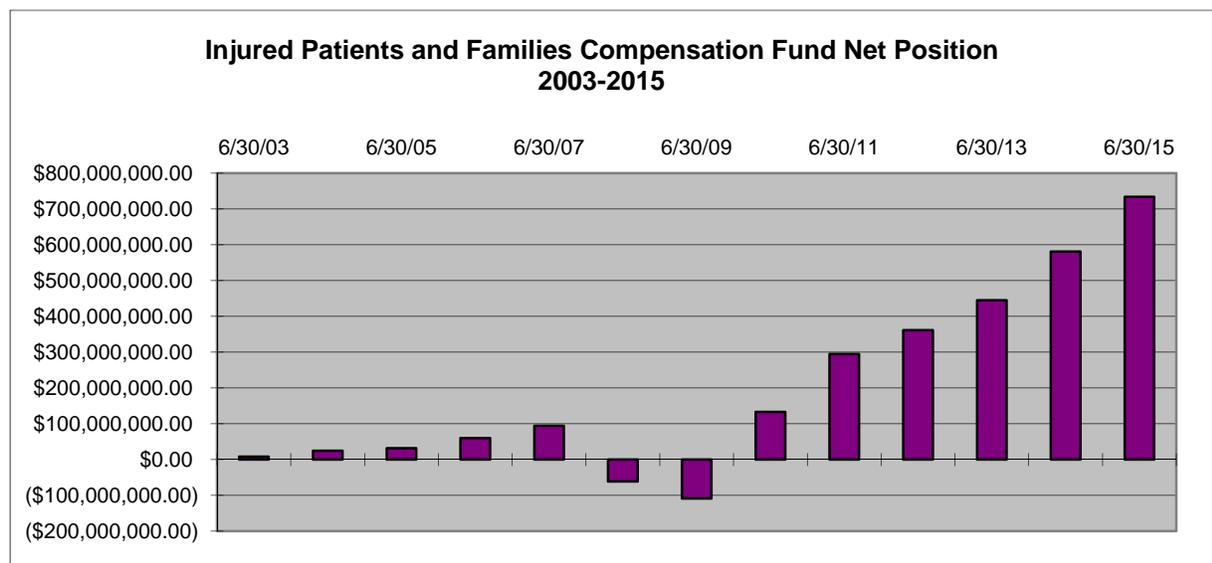


## Financial Statistics

Attached as Exhibit 1 is the financial statement for the Fund for the fiscal year ending June 30, 2015. The Fund reports its financial operations on a July 1 to June 30, succeeding year basis. The financial statistics will use "fiscal 2015" to disclose the one-year time July 1, 2014, to June 30, 2015, and similarly for other fiscal years.

The Fund reported net position of \$733,852,348 as of June 30, 2015.

The following graph reflects the Fund's net position over the last 13 fiscal years.



Medical malpractice, with its extended reporting and settlement patterns, is especially difficult to estimate, and the ultimate claim payments will differ from the originally projected liabilities. The Fund reports its liabilities for losses and loss adjustment expenses on a discounted basis. This means that the actuarially determined amount that is expected to be needed to pay all claims that have occurred, and those that will occur during the current fiscal year, has been reduced by the amount of investment income that is expected to be received during the payout period. Any changes in interest rates or investment balance will have an impact on the financial position of the Fund.

The significant shift in the Fund's equity position from fiscal 2009 to 2010 was primarily due to the booking of an asset associated with the Supreme Court decision declaring the \$200 million transfer under 2007 Wisconsin Act 20 unconstitutional and the return of \$233.7 million, which was received in 2011. The increase in net position from fiscal 2011 to 2015 was the result of an increase in investment income, decreases in loss and LAE liabilities, as well as a decrease in the amount of losses paid.

The Fund's next progress report, due March 1, 2017, will include an update on the Fund's activities during 2016.

**WISCONSIN INJURED PATIENTS AND FAMILIES  
COMPENSATION FUND  
Statement of Net Position  
6/30/2015**

**ASSETS**

Current Assets	
Cash	\$ 295,463
State Investment Fund Shares	18,710,496
Short-Term Investments (Market Value)	45,670,008
Bond Investment Income Receivable	10,276,318
State Shares Interest Receivable	6,153
Investments and Security Lending Receivable	12,736
Assessments Receivable	278,670
Less: Allowance for Uncollectible Accounts	(832)
Prepaid Items	7,201
Supplies Inventory and Other Assets	2,127
Other Receivables	<u>17,142</u>
Total Current Assets	<u>75,275,481</u>
Noncurrent Assets	
Restricted Cash – Liability for FME Account	38,355,504
Long-term Investments (market value)	1,109,437,616
Capital Assets, Net of Accumulated Depreciation	872,084
Other, GASB 68	<u>68,282</u>
Total Noncurrent Assets	<u>1,148,733,486</u>
Total Assets	<u>1,224,008,967</u>
Deferred Outflows of Resources	<u>69,833</u>
<b>Total Assets and Deferred Outflows of Resources</b>	<b><u>\$ 1,224,078,800</u></b>

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**LIABILITIES**

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## Current Liabilities

Future Benefits and Loss Liabilities - Short Term	\$ 64,041,641
Assessments Received in Advance	2,116,322
Provider Refunds Payable	1,781,391
General and Administrative Expenses Payable	14,087
Medical Mediation Panels Payable	(1,535)
Due to Other Funds	161,471
Compensated Absences	<u>19,695</u>

Total Current Liabilities 68,133,073

## Noncurrent Liabilities

## Loss liabilities:

Liability for IBNR	441,007,773
Liability for Reported Losses	4,000,900
Liability for LAE	<u>80,414,776</u>

Estimated Loss Liabilities 525,423,449  
Less: Amount Representing Interest (79,739,980)

Discounted Loss Liabilities 445,683,469  
Liabilities for Future Medical Expenses 38,355,504  
Contributions Being Held 2,000,000

Total Loss liabilities 486,038,973  
Less: Loss Liabilities, Current Portion (64,041,641)  
Noncurrent Loss Liabilities 421,997,332

Compensated Absences – Long Term 45,012  
Other Postemployment Benefits 49,973

Total Noncurrent Liabilities 422,092,317

**Total Liabilities** 490,225,390

**Deferred Inflows of Resources** 1,062

**Total Liabilities and Deferred Inflows of Resources** 490,226,452

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**NET POSITION**

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## Net Position:

Invested in Capital Assets, Net of Related Debt	872,084
Restricted for Injured Patients and Families	<u>732,980,264</u>

**Total Net Position** 733,852,348

**Total Liabilities, Deferred Inflows of Resources and Net Position** **\$1,224,078,800**

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**WISCONSIN INJURED PATIENTS AND FAMILIES  
 COMPENSATION FUND  
 Statement of Revenues, Expenses, and Changes in Fund Net Position  
 For the Fiscal Year Ended  
 6/30/2015**

**OPERATING REVENUES**

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Assessments	\$ 33,735,169
Assessment Interest Income	3,527
Administrative Fee Income	<u>34,554</u>
 Total Operating Revenues	 <u>33,773,250</u>

**OPERATING EXPENSES**

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Underwriting Expenses:	
Net Losses Paid	16,817,086
Loss Adjustment Expense Paid	4,384,870
Risk Management Expenses	107,443
Medical Expenses Paid	1,748,667
Change in Liability for IBNR	(105,006,192)
Change in Liability for Reported Losses	(7,054,021)
Change in Liability for Loss Adjustment Expense	(18,873,588)
Change in Amount Representing Interest	19,765,998
Change in Liability for Future Medical Expense	<u>(1,249,314)</u>
Total Underwriting Expenses	(89,359,050)
General and Administrative Expenses	528,972
Depreciation Expense	<u>78,416</u>
 Total Operating Expenses	 <u>(88,751,663)</u>
 Operating Income (Loss)	 122,524,913

**NONOPERATING REVENUES (EXPENSES)**

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Investment Income	30,200,545
Miscellaneous Revenue	<u>34,220</u>
Change in Net Assets	152,759,678
Transfers to the General Fund	<u>(15,209)</u>
Change in Net Position	152,744,468

**NET POSITION**

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Net Position—Beginning of the Period	<u>581,107,880</u>
 Net Position—End of the Period	 <u><b>\$733,852,348</b></u>

**WISCONSIN INJURED PATIENTS AND FAMILIES  
COMPENSATION FUND  
Statement of Cash Flows  
6/30/2015**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash Received from Providers for Assessments	\$ 34,174,418
Cash Received from Other Sources	192,068
Cash Paid for Losses	(14,817,086)
Cash Paid for Loss Adjustment Expenses	(4,384,870)
Cash Paid for Future Medical Expenses	(1,748,667)
Cash Paid for Other Expenses	(1,060,454)
Cash Paid to Providers for Refunds of Fund Fees	(303,091)
Cash Paid for Medical Mediation Panel Fees	<u>(100,350)</u>
Net Cash Provided by Operating Activities	11,951,968

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Transfers Out to Other Post-Employment Benefit	<u>(15,209)</u>
Net Cash Provided by Capital or Related Financing Activities	(15,209)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest Received	33,496,839
Cash Received as Proceeds from Sales of Investments	72,086,954
Cash Paid for Purchase of Investment Securities	<u>(128,854,961)</u>
Net Cash Provided by (Used for) Investment Activities	<u>(23,271,168)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(11,334,409)
Cash and Cash Equivalents—Beginning of the Year	<u>68,695,872</u>
<b>Cash and Cash Equivalents—End of the Year</b>	<b><u>\$ 57,361,463</u></b>

**RECONCILIATION OF OPERATING INCOME TO  
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES**

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Operating Income	\$ 122,524,913
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Miscellaneous Non-Operating Income	34,220
Depreciation Expense	78,416
Change in "Due to" related to an accrual of investment income	161,471
Changes to Assets and Liabilities	
Increase in Assessments Receivable	(33,144)
Increase in Other Assets	(275,914)
Decrease in Loss Liabilities	(110,417,116)
Decrease in Deferred Revenue	(521,629)
Increase in Other Liabilities	<u>400,752</u>
Total Adjustments	<u>(110,572,944)</u>
<b>Net Cash Provided by Operating Activities</b>	<b><u>\$ 11,951,968</u></b>
Noncash Activities:	
Net Change in Unrealized Gains and Losses	\$ 4,290,645
Other	\$ 7,294,215

## Notes to the Financial Statements

### 1. Description of the Injured Patients and Families Compensation Fund (Fund)

The Fund is part of the state of Wisconsin financial reporting entity and is reported as a major enterprise fund in the State's Comprehensive Annual Financial Report. The Fund, formerly known as the Patients Compensation Fund, was created in 1975 for the purpose of paying that portion of medical malpractice claims exceeding the legal primary insurance limits prescribed in s. 655.23 (4), Wis. Stat., or the maximum liability limit for which the health care provider is insured, whichever limit is greater. Most health care providers permanently practicing or operating in the state of Wisconsin are required to pay annual assessments.

Management of the Fund is vested with the 13-member Board of Governors, which is chaired by the Commissioner of Insurance. The Board has designated the Commissioner of Insurance as the administrator of the Fund. Similarly, under s. 655.27 (2), Wis. Stat., the Commissioner shall either provide staff services necessary for the operation of the Fund or, with the approval of the Board, contract for all or part of these services. During fiscal 2015, fiscal 2014, and fiscal 2013, the Board contracted for the Fund's actuarial, risk management, and claims administration services.

### 2. Summary of Significant Accounting Policies

#### A. Fund Accounting and Basis of Presentation

The financial statements of the Fund have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds. The accompanying financial statements were prepared based upon the flow of economic resources focus and full accrual basis of accounting, with revenues recognized when earned and expenses recognized when incurred.

The Statement of Revenues, Expenses, and Changes in Fund Net Position classifies the Fund's fiscal year activity as either operating or non-operating. Because the Fund is an enterprise fund, which is a type of proprietary fund, it accounts for operations in a manner similar to private businesses in which operating revenues are derived from exchange transactions. Assessments, which are received from health care providers in exchange for coverage under the Fund, represent a significant component of operating revenues. Operating expenses include underwriting and administrative expenses.

Certain revenues and expenses that are not related to the Fund's primary purpose, such as interest expense, are reported as non-operating revenues and expenses. The most significant source of the Fund's non-operating income is investment income.

The Fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure. Further, the Fund has not elected to apply the provisions of relevant pronouncements of FASB issued after November 30, 1989.

#### B. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant changes in future years are the liabilities for unpaid losses and loss adjustment expenses. In estimating these liabilities, management uses the methodology discussed in Note 4 on ultimate and discounted loss liabilities.

C. Cash and Cash Equivalents

Cash and cash equivalents include cash balances deposited with the state and shares in the State Investment Fund, which is a short-term pool of state and local funds. The State Investment Fund shares are included in both the current portion of cash and cash equivalents and noncurrent portion restricted for future medical expenses.

D. Investment Valuation

Investments of the Fund consist of fixed income securities and shares in equity index funds. All investments are managed by the State of Wisconsin Investment Board and are reported at fair value. Fair value information is determined using quoted market prices.

E. Assessments

Assessments are billed and recognized as revenues on a fiscal year basis, which is also the policy year. Assessments received for the next fiscal year are treated as deferred revenue and reported as assessments received in advance. Accounts of providers are automatically credited and reported as provider refunds payable when primary insurance lapses.

F. Loss Liabilities

Loss liabilities are estimated based on recommendations of a consulting actuary and are discounted to the extent that they are matched by cash and invested assets. The uncertainties inherent in projecting the frequency and severity of claims, the Fund's unlimited liability coverage for economic damages, and extended reporting and settlement periods make it likely that the amounts ultimately paid will differ from the recorded estimated liabilities.

G. Policy Acquisition Costs

Since the Fund has no marketing staff and incurs no sales commissions, acquisition costs are minimal and charged to operations as incurred.

H. Capital Assets

The Fund capitalizes all assets, both tangible and intangible, which have an historic cost or estimated historic cost in excess of \$5,000 and a useful life of two or more years. As of June 30, 2015, the Fund's capital assets totaled \$872,084 and consisted of two assets. The internally developed provider system software which is depreciated on a straight-line basis over fifteen years and the microfiche reader which is depreciated on a straight-line basis over five years

I. Net Assets

Section 655.27 (6), Wis. Stat., requires the Fund to be held in an irrevocable trust and used for future claim payments for injured patients and families. Available net position is restricted for injured patients and families and totaled \$732,980,264 as of June 30, 2015, \$580,436,312 as of June 30, 2014, and \$444,449,358 as of June 30, 2013.

J. Employee Compensated Absences

The Fund's compensated absence liability consists of accumulated unpaid leave, compensatory time, personal holiday hours, and Saturday/legal holiday hours earned and vested as of June 30. The compensated absences liability is classified as either a short-term liability under general and administrative expenses payable or a long-term liability under compensated absences and other post-employment benefit (OPEB) liabilities based upon an estimate determined by management. The long-term liability portion of the compensated absences liability generally is not paid out until retirement.

### **3. New Accounting Standard**

In June 2011, GASB issued Statement Number 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. The objective of this statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources in a statement of financial position and related disclosures. The adoption of this statement requires OCI to make changes and replace the Balance Sheet with the Statement of Net Position. In addition, the Statement of Revenues, Expenses and Changes in Fund Net Assets was replaced with the Statement of Revenues, Expenses and Changes in Fund Net Position. These changes were retroactively applied to the FY 2011-12 financial statements included in this report.

### **4. Deposits and Investments**

The Fund's deposits consist of cash deposited in the state's bank, which totaled \$295,463 as of June 30, 2015, \$1,194,872 as of June 30, 2014, and \$1,846,946 as of June 30, 2013.

The Fund's investments are managed by the State of Wisconsin Investment Board, whose objective is to maintain a portfolio of investments to provide a balance between capital appreciation, preservation of capital, and current income consistent with the needs of the Fund. Section 25.17 (3) (a), Wis. Stat., allows investments in loans, securities, and any other investments as authorized by s. 620.22, Wis. Stat. Classes of investments permitted by s. 620.22, Wis. Stat., include bonds of governmental units or private corporations, loans secured by mortgages, preferred or common stock, real property, and other investments not specifically prohibited by statute. In addition, the Board of Governors established a more specific investment policy that limits equity investments to 20.0% of the Fund's total portfolio.

Although classified as cash and cash equivalents on the Statement of Net Assets and the Statement of Cash Flows, shares in the State Investment Fund are subject to investment risk disclosures. The State Investment Fund is a short-term investment pool of state and local funds managed by the State of Wisconsin Investment Board, with oversight by its Board of Trustees and in accordance with Wisconsin Statutes. It is not registered with the Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported at fair value as of June 30. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17 (3) (b), (ba), (bd), and (dg), Wis. Stat., and include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States including solvent financial institutions in Wisconsin, and bankers acceptances. The State of Wisconsin Investment Board's Board of Trustees may specifically approve other prudent legal investments. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The market values of the Fund's investments at fiscal year-end are as follows:

	June 30,2015	June 30, 2014	June 30, 2013
<u>Short-term Investment Pool</u>			
State Investment Fund <sup>1</sup>	\$ 57,066,000	\$ 67,501,000	\$ 80,723,000
<u>Fixed-Income:</u>			
U.S. Government and Agency	394,325,230	347,176,767	316,424,993
Industrial	239,464,385	238,835,133	202,378,336
Transportation	37,982,924	39,180,152	35,742,395
Finance	130,220,688	131,017,628	113,628,669
Utilities	<u>130,854,133</u>	<u>134,772,148</u>	<u>118,936,966</u>
Subtotal	<u>932,847,360</u>	<u>890,981,828</u>	<u>787,111,359</u>
<u>Equities:</u>			
Russell 2000 Index Fund	17,976,570	16,820,901	16,821,548
S & P 500 Index Fund	159,480,071	148,392,163	143,929,034
S & P 400 Index Fund	15,222,483	14,291,052	14,139,172
MSCI World Ex-US Index Fund	<u>29,581,140</u>	<u>31,191,615</u>	<u>24,807,440</u>
Subtotal	<u>222,260,264</u>	<u>210,695,731</u>	<u>199,697,194</u>
Total Investments	<u>\$1,212,173,624</u>	<u>\$1,169,178,559</u>	<u>\$1,067,531,553</u>

<sup>1</sup>State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Assets.

*Custodial Credit Risk - Deposits*—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Fund will not be able to recover deposits that are in possession of an outside party. The Fund does not have a deposit policy specifically for custodial credit risk. None of the Fund's bank balances as of June 30, 2014, June 30, 2013, and June 30, 2012, were exposed to custodial credit risk.

*Custodial Credit Risk - Investments*—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investments that are in possession of an outside party. The Fund does not have an investment policy specifically for custodial credit risk. As of June 30, 2014, June 30, 2013, and June 30, 2012, the Fund did not have any investments exposed to custodial credit risk.

*Credit Risk*—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Fund. The Fund's investment guidelines provide that, at the time of purchase, at least 80.0% of the bond portfolio must be rated A3/A- or better by Nationally Recognized Statistical Rating Organizations, using the lower of split ratings. In addition, the Fund's investment guidelines require that a minimum of 30.0% of the Fund's investable assets (excluding the cash restricted for payment of future medical expenses) must be invested in U.S. Treasury or Agency Securities. The State Investment Fund is unrated; however, its guidelines establish specific maximum exposure limits by security type based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations.

The credit exposures aggregated by credit rating as of June 30, were as follows:

Credit Rating:	June 30, 2014		June 30, 2013		June 30, 2012	
	Fair Value	Percent	Fair Value	Percent	Fair Value	Percent
AAA	\$ 15,812,254	1.7%	\$ 16,450,397	1.9%	\$ 19,038,197	2.2%
AA	378,516,407	39.5	314,269,524	36.2	323,223,113	37.9
A	324,842,305	33.9	294,723,254	33.9	292,889,207	34.3
BBB	160,898,421	16.8	135,141,790	15.6	131,005,561	15.4
BB	10,711,759	1.1	26,526,344	3.1	9,529,916	1.1
B	0	0.0	0	0.0	3,375,000	0.4
C or Lower	0	0.0	0	0.0	0	0.0
Not Rated	6,250	0.0	50	0.0	10,000	0.0
Subtotal	<u>890,787,396</u>	<u>93.0</u>	<u>787,111,359</u>	<u>90.7</u>	<u>779,070,994</u>	<u>91.3</u>
State Investment Fund (unrated)	<u>67,501,000</u>	<u>7.0</u>	<u>80,723,000</u>	<u>9.3</u>	<u>73,898,000</u>	<u>8.7</u>
Total	<u>\$958,288,396</u>	<u>100.0%</u>	<u>\$867,834,359</u>	<u>100.0%</u>	<u>\$852,968,994</u>	<u>100.0%</u>

**Concentration of Credit Risk**—Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The Fund's investment guidelines do not allow for investments in any one single issuer that is in excess of 5.0% of the Fund's bond portfolio based on market value at the time of purchase. Securities of the United States government and its agencies are excluded from that limitation. As of June 30, 2014, June 30, 2013, and June 30, 2012, the Fund did not have more than 5.0% of its total investments in a single issuer, excluding the United States government and its agencies. Concentration of credit risk requirements are also not applicable to pooled investments, such as the State Investment Fund.

**Interest Rate Risk**—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund uses the duration method to identify and manage its interest rate risk. The Fund's investment guidelines related to interest rate risk provide that the average duration of the aggregate bond portfolio should be less than ten years. The State Investment Fund uses the weighted average maturity method to analyze interest rate risk. Its investment guidelines mandate that the weighted average maturity for the entire portfolio not exceed one year.

The following were the durations for each type of fixed-income security held, as well as for the State Investment Fund:

Type of Security:	June 30, 2014		June 30, 2013		June 30, 2012	
	Fair Value	Duration (In Years)	Fair value	Duration (In Years)	Fair value	Duration (In Years)
Gov/Agency	\$346,982,335	5.77	\$316,201,313	5.35	\$294,943,115	5.28
Corporate	<u>543,805,061</u>	6.06	<u>470,910,046</u>	6.21	<u>484,127,879</u>	5.85
Subtotal	890,787,396	5.95	787,111,359	5.86	779,070,994	5.64
State Investment Fund <sup>1</sup>	<u>67,501,000</u>	0.24	<u>80,723,000</u>	0.09	<u>73,898,000</u>	0.21
Total	<u>\$958,288,396</u>	<u>5.55</u>	<u>\$867,834,359</u>	<u>5.33</u>	<u>\$852,968,994</u>	<u>5.17</u>

<sup>1</sup>State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Assets.

**Foreign Currency Risk**—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund's investment guidelines do not specifically address foreign currency risk. As of June 30, 2014, June 30, 2013, and June 30, 2012, the Fund did not directly own any issues denominated in a foreign currency.

## 5. Total Loss Liabilities

### A. Estimated Loss Liabilities

Loss liabilities include individual case estimates for reported losses and estimates for losses that have been incurred but not reported (IBNR), based upon the projected ultimate losses recommended by a consulting actuary. Individual case estimates of the liability for reported losses and net losses paid from inception of the Fund are deducted from the projected ultimate loss liabilities to determine the liability for IBNR losses as follows:

	June 30, 2014	June 30, 2013	June 30, 2012
Projected Ultimate Loss Liability	\$1,403,311,144	\$1,419,396,837	\$1,448,982,159
Less:			
Net Losses Paid from Inception	(846,242,258)	(833,143,325)	(809,624,293)
Liability for Reported Losses	<u>(11,054,921)</u>	<u>(8,065,109)</u>	<u>(20,146,674)</u>
Liability for IBNR Losses	<u>\$ 546,013,965</u>	<u>\$ 578,188,403</u>	<u>\$ 619,211,192</u>

The Fund's consulting actuary developed a best estimate of the loss liabilities, and the Board of Governors approved the addition of an explicit 25.0% risk margin to the best estimate for June 30, 2014, June 30, 2013, and June 30, 2012. The explicit risk margin is applied to ensure that the loss liability estimates remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments.

Loss liabilities also include a provision for the estimated future payment of costs to settle claims. The actuary estimates the ultimate loss adjustment expense (LAE) using data available through September 30 of the fiscal year. The actuary estimates LAE at 18.0% of the estimated unpaid loss liabilities for June 30, 2014, June 30, 2013, and June 30, 2012. The percentage used in the financial statements will differ slightly since the actuary's estimate will be adjusted to reflect actual LAE payments. The LAE paid from inception of the Fund are deducted from the projected ultimate LAE provision to arrive at the liability for LAE as follows:

	June 30, 2014	June 30, 2013	June 30, 2012
Projected Ultimate LAE Liability	\$186,631,318	\$190,389,324	\$190,818,020
Less:			
Net LAE Paid from Inception	<u>(87,342,955)</u>	<u>(82,960,586)</u>	<u>(78,587,167)</u>
Liability for LAE	<u>\$ 99,288,363</u>	<u>\$107,428,738</u>	<u>\$112,230,853</u>

### B. Re-estimated Loss Liabilities

Because of the uncertainties inherent in projecting medical malpractice claims with unlimited liability coverage, estimates of the Fund's loss liability and liability for LAE are continually reviewed and adjusted as the Fund gains additional experience. Such adjustments are reflected in current operations. Because of the changes in these estimates for prior years, the total underwriting expenses reported for the year are not necessarily indicative of the loss experience for that year.

### C. Discounted Loss Liabilities

Section Ins 17.27 (3), Wis. Adm. Code, requires the liability for reported losses, liability for IBNR losses, and liability for LAE to be maintained on a present-value basis, with the difference from full value being reported as a contra account to the loss liabilities. The loss liabilities are discounted only to the extent that they are matched by cash and invested assets. The actuarially determined

discount factors, which are based on investment yield assumptions of 4.5% for fiscal 2014 and 2013, and 5.0% for fiscal 2012 that are approved by the Board of Governors, were 0.8484 for fiscal 2014, 0.8486 for fiscal 2013, and 0.8406 for fiscal 2012.

D. Future Medical Expense Liability

Section 655.015, Wis. Stat., requires accounts to be established if a settlement or judgment provides for future medical expense (FME) payments in excess of \$100,000. In addition to amounts provided by the Fund, this account may also include deposits provided by the primary insurer for any portion of future medical expenses for which they are liable. The accounts are managed by the Fund and earn a proportionate share of the Fund's interest. Any account balance remaining when a claimant dies reverts back to the Fund.

E. Contributions Being Held Liability

A primary insurer may voluntarily present a nonrefundable payment to the Fund generally equal to the amount of primary coverage in effect for the related claim. This payment from the primary insurer is negotiable with the Fund in exchange for a release of payment for any future defense costs that may be incurred on the claim. This amount is held as a liability on the Fund's financial statements until the time a payment is made on the claim. No contributions were being held as of June 30, 2014, June 30, 2013, and June 30, 2012.

F. Loss Liabilities Balances and Activities

	Fiscal 2014	Fiscal 2013	Fiscal 2012
Total loss liabilities, beginning of the year	\$627,973,859	\$665,777,868	\$636,503,075
Incurred losses and related expenses for the current year and changes in the estimated liabilities for prior year losses and related expenses	(14,347,689)	(15,203,494)	35,826,745
Less: Current year payments for losses, LAE, and FME incurred in the current and prior years	<u>(17,170,081)</u>	<u>(22,600,515)</u>	<u>(6,551,952)</u>
Total loss liabilities, end of the year	596,456,089	627,973,859	665,777,868
Less: Current portion	<u>(80,056,260)</u>	<u>(85,521,593)</u>	<u>(82,214,231)</u>
Noncurrent portion	<u>\$516,399,829</u>	<u>\$542,452,266</u>	<u>\$583,563,637</u>

6. Medical Mediation Panel Fees

Section Ins. 17.27 (3), Wis. Adm. Code, requires the fees collected for administration of the Medical Mediation Panel be included in the Fund's financial reports, but that they should not be regarded as assets or liabilities of the Fund or otherwise taken into consideration in determining assessment levels to pay claims. Panel fees are charged providers with Fund assessments, based upon estimates for services provided the Fund by the Supreme Court. For fiscal 2014, the Supreme Court estimated a \$0 panel fee obligation. The Fund remitted panel fees to the Supreme Court of \$313,197 in fiscal 2013, and \$364,946 was remitted in fiscal 2012.

7. Claim Annuities

The settlement of a claim may result in the purchase of an annuity. Under specific annuity arrangements, the Fund may have ultimate responsibility for annuity payments if the annuity company defaults on annuity payments.

One of the Fund's annuity providers defaulted on \$109,168 in annuity payments through June 30, 2014, which the Fund subsequently paid. The annuity provider is currently making the majority of these

annuity payments, but the Fund continues to make monthly annuity payments of \$130, and additional lump-sum payments due every five years through 2025, to cover defaulted payments. Through June 30, 2014, the Fund has received a total reimbursement of \$92,797, which includes interest. It is unclear when the annuity provider will be able to make the remaining annuity payments and whether the Fund will be able to recover the remaining annuity payments made on the behalf of the annuity provider.

The total estimated replacement value of the Fund's annuities of which the Fund remains the owner was \$32.8 million as of June 30, 2014, June 30, 2013, and June 30, 2012. Of this amount, \$651,753 represents the replacement value of the annuity in default as of June 30, 2014.

## **8. Employee Retirement Plan**

As permanent full-time employees of the state of Wisconsin, Fund employees are participants in the Wisconsin Retirement System (WRS), a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stat. Contributions that the Fund pays to WRS are included as part of general and administrative expenses and totaled \$38,733 for fiscal 2014, \$32,419 for fiscal 2013, and \$36,699 for fiscal 2012. The relative position of the Fund in the WRS is not available because the WRS is a statewide, multiple-employer plan.

In accordance with GASB issued Statement No. 45, the state is required to report other post-employment benefit (OPEB) expenses, which the Fund reports as part of general and administrative expenses. OPEBs include an implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the state's health insurance program and postemployment coverage in the state's life insurance program. Included as part of the noncurrent compensated absences and OPEB liabilities account on the Statement of Net Assets, OPEB liabilities were \$42,541 as of June 30, 2014, \$44,591 as of June 30, 2013, and \$39,251 as of June 30, 2012.

Copies of the separately issued financial reports for the WRS and the life insurance program are available on the Department of Employee Trust Funds' Web site, <http://etf.wi.gov>. The disclosures for the health insurance plan are included in the State's Comprehensive Annual Financial Report, available on the Department of Administration's Web site, <http://www.doa.wi.gov>.

## **9. Transfers Out to the General Fund**

Sections 9101 (9) and (9q) of 2003 Wisconsin Act 33 gave the state of Wisconsin authority to issue annual appropriation bonds to pay off certain unfunded liabilities in the pension and other employee benefit programs, resulting in cost savings to the state. Section 16.529, Wis. Stat., requires state agencies to make certain transfers to the General Fund for this purpose, which included all of the balance of this account for the Injured Patients and Families Compensation Fund for fiscal 2014, fiscal 2013, and fiscal 2012.

## **10. Audit Adjustments**

There are no audit adjustments in the Commissioner of Insurance's annual reports to the Governor and the Legislature.

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