Report 19-9
June 2019

Injured Patients and Families Compensation Fund

FY 2015-16, FY 2016-17, and FY 2017-18

Office of the Commissioner of Insurance

STATE OF WISCONSIN

Legislative Audit Bureau

Report 19-9
June 2019

Injured Patients and Families Compensation Fund

FY 2015-16, FY 2016-17, and FY 2017-18

Office of the Commissioner of Insurance

Report 19-9
June 2019

LEGISLATIVE AUDIT BUREAU

State Auditor
Joe Chrisman

Financial Audit Director
Kendra Eppler

Team Leaders
Nathan Heimler
Emily Pape

Auditors
David Lisk
Heather Murray
Katie Natzke
Matt Rossi

Publications Designer and Editor
Susan Skowronski

The Legislative Audit Bureau supports the Legislature in its oversight of Wisconsin government and its promotion of efficient and effective state operations by providing nonpartisan, independent, accurate, and timely audits and evaluations of public finances and the management of public programs. Bureau reports typically contain reviews of financial transactions, analyses of agency performance or public policy issues, conclusions regarding the causes of problems found, and recommendations for improvement.

Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau.

The Bureau accepts confidential tips about fraud, waste, and mismanagement in any Wisconsin state agency or program through its hotline at 1-877-FRAUD-17.

For more information, visit *www.legis.wisconsin.gov/lab.*

Contact the Bureau at 22 East Mifflin Street, Suite 500, Madison, Wisconsin 53703; *AskLAB@legis.wisconsin.gov*; or (608) 266-2818.

CONTENTS

STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

June 5, 2019

Senator Robert Cowles and
Representative Samantha Kerkman, Co-Chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1) (de), Wis. Stats., we have completed a financial audit of the Injured Patients and Families Compensation Fund, which insures health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. The Fund is overseen by a Board of Governors and administered by the Office of the Commissioner of Insurance (OCI). We have provided an unmodified opinion on the Fund's financial statements as of and for the years ended June 30, 2018, June 30, 2017, and June 30, 2016.

The Fund's net position continued to increase during our audit period, and was $1.0 billion as of June 30, 2018. In an attempt to reduce the Fund's net position toward the target range, the Board of Governors reduced rates for assessments on providers participating in the Fund by 30 percent or more in each year of our audit period. The increase in the Fund's net position was driven primarily by positive investment income and decreasing estimated loss liabilities.

There is no limit to the compensation the Fund will pay on behalf of participating providers for economic damages, such as medical costs and loss of income. Since April 6, 2006, compensation paid by the Fund for noneconomic damages, such as loss of companionship and affection, has been statutorily limited to $750,000. This limit was upheld in a ruling by the Wisconsin Supreme Court in June 2018.

We report significant deficiencies in internal control related to the financial reporting process. These deficiencies are included in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is on page 51.

We appreciate the courtesy and cooperation extended to us by the staff of OCI and the Fund's contractors. A response from OCI follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/KE/ss

Introduction ■

2003 Wisconsin Act 111 established the Fund as an irrevocable trust for the sole benefit of participating health care providers and claimants.

The Injured Patients and Families Compensation Fund insures participating physicians and other health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established in statutes. The Fund was created as the Patients Compensation Fund in Chapter 37, Laws of 1975, in response to concerns over the cost and availability of medical malpractice insurance. 2003 Wisconsin Act 111 changed the Fund's name to the Injured Patients and Families Compensation Fund and established it as an irrevocable trust for the sole benefit of health care providers participating in the Fund and claimants. Wisconsin is one of at least 13 states with compensation funds for patients, although the structure of each fund varies by state.

Most health care providers in Wisconsin are required to purchase secondary medical malpractice insurance from the Fund.

Statutes require most health care providers that operate or have permanent practices in Wisconsin to maintain primary medical malpractice coverage of $1.0 million for each incident and $3.0 million per policy year. Statutes also require participation in the Fund, which provides unlimited secondary medical malpractice coverage for economic damages that exceed the primary medical malpractice coverage.

The Fund insures individual health care providers, such as physicians and nurse anesthetists; institutions, such as hospitals, ambulatory surgery centers, and certain nursing homes; entities, such as medical partnerships, corporations, and cooperatives; and hospital-owned or -controlled entities. Certain providers are statutorily exempt from participation in the Fund, including public employees and those providing services for less than 241 hours a year. As of June 30, 2018, 16,807 individual providers, institutions, and other entities participated in the Fund.

The Fund, which is administered by the Office of the Commissioner of Insurance (OCI), is governed by a 13-member Board of Governors chaired by the Commissioner of Insurance. The Commissioner has statutory responsibility for administering the Fund. During the three-year audit period, OCI contracted for claims administration services, actuarial services, and risk management services.

The Fund's investments are managed by the State of Wisconsin Investment Board (SWIB), which during our audit period contracted with external investment managers to oversee the Fund's investment portfolio. The Fund invests primarily in fixed-income securities and equity securities. As of June 30, 2018, the Fund's investment policy allows investment in equity securities up to 20.0 percent of the Fund's total investment portfolio. The Fund's cash balances are accounted for in the State Investment Fund, which is a short-term pool of state and local funds managed by SWIB.

Statutes require the Legislative Audit Bureau to perform a financial audit of the Injured Patients and Families Compensation Fund at least once every three years. In completing our audit, we reviewed the Fund's internal controls; assessed the fair presentation of its financial statements as of and for the years ended June 30, 2018, June 30, 2017, and June 30, 2016; and reviewed compliance with certain statutory provisions. We also followed up on prior audit recommendations (report 16-4) related to the completion of actuarial audits and management of the Fund's net position.

Claim Payments

There is no limit to the compensation the Fund will pay on behalf of participating providers for economic damages, such as medical costs and loss of income. If the Fund does not have sufficient funds to pay the claims, Wisconsin Statutes allow up to $100.0 million to be supplemented by general purpose revenue. Prior to April 6, 2006, awards of noneconomic damages in medical malpractice claims, which include compensation for suffering, mental distress, and loss of companionship and affection, were also not limited because a 2005 Wisconsin Supreme Court ruling found the limit in place at that time to be unconstitutional. Since April 6, 2006, awards of noneconomic damages have been limited by Wisconsin Statutes to $750,000. This limit was upheld by the Wisconsin Supreme Court in a June 2018 ruling.

From its inception through June 30, 2018, the Fund has paid $874.9 million for 673 claims.

From its inception in 1975 through June 30, 2018, the Fund has paid $874.9 million for 673 claims. During this period, individual claim payments ranged from $4,000 to $34.3 million. As shown in Table 1, 70.9 percent of paid claims were for amounts less than $1.0 million. However, these 477 paid claims account for only 18.7 percent of the Fund's total payments for all claims through June 30, 2018. In contrast, 43 claims with payments of $5.0 million or more represent 44.9 percent of the total claim payments over that time period.

Table 1

Paid Claims from the Fund's Inception through June 30, 2018

Claim Amount	Number of Paid Claims	Percentage of Paid Claims	Amount Paid for All Claims	Percentage of Total Payments for All Claims
$5.0 Million or More	43	6.4%	$392,715,901	44.9%
At Least $1.0 Million but Less Than $5.0 Million	153	22.7	318,067,934	36.4
Less Than $1.0 Million	477	70.9	164,073,186	18.7
Total	**673**	**100.0%**	**$874,857,021**	**100.0%**

For each claim for which future medical expense payments from the Fund exceed $100,000, the Fund is required to establish an account for the claimant. The Fund is to credit to each account of the future medical expense payments to be made as well as its share of interest earned by the Fund. Medical expenses are subsequently paid from the account and, if a balance remains at the time of the claimant's death, it is returned to the Fund. Interest earnings credited to these accounts were determined to not accurately represent each account's share of the interest earned by the Fund. In December 2018, the Board of Governors voted to modify the basis for determining the interest earnings credited to these accounts. As a result, interest earnings credited to these accounts increased.

As shown in Table 2, the Fund made claim payments of $10.0 million or more for ten claims from its inception through June 30, 2018. The two largest claim payments were for incidents that occurred prior to April 2006, and included significant noneconomic damage awards that were not subject to any limit. The largest noneconomic damages award was $11.5 million, which was included as part of a $34.3 million claim paid in fiscal year (FY) 2007-08.

Table 2

Claim Payments of $10 Million or More through June 30, 2018[1]
(in millions)

Fiscal Year of Incident	Fiscal Year of Payment	Claimant Allegations	Economic Damages	Noneconomic Damages	Total[2]
2003-04	2007-08	Negligent blood transfusion caused cardiac arrest and brain damage.	$22.8	$11.5	$34.3
2004-05	2010-11	Negligent labor and delivery caused brain damage.	11.0	11.0	22.0
1985-86	1992-93	Diet pills prescribed without a complete physical evaluation caused cardiac arrest and brain damage.	9.0	9.0	18.0
2006-07	2008-09	Improperly performed surgical procedure caused brain damage.	–[3]	–[3]	16.3
1993-94	1996-97	Negligent treatment caused quadriplegia.	–[3]	–[3]	15.6
1993-94	2000-01	Initial surgery and follow-up treatments of pinched nerve were negligent, which caused continuing pain.	4.3	9.3	13.6
2000-01	2012-13	Negligent delivery caused brain damage.	8.9	3.1	12.0
2003-04	2006-07	Negligent delivery caused brain damage.	11.0	0.0	11.0
1996-97	2005-06	Negligent treatment caused brain damage.	9.1	1.0	10.1
2001-02	2006-07	Negligent labor and delivery caused brain damage.	–[3]	–[3]	10.0

[1] Subsequent to June 30, 3018, the Fund settled a claim for $22.5 million.

[2] Includes interest on losses paid and amounts credited to future medical expense accounts.

[3] The claim payment was based on a settlement in which the economic and noneconomic damage amounts were not specified.

In April 2019, the Fund settled a claim for $22.5 million related to negligent prolonged low blood pressure during surgery that caused brain damage. The settlement for this claim did not specify the amounts for economic damages and noneconomic damages, which are statutorily limited to $750,000. This claim was considered in establishing the Fund's loss liabilities as of June 30, 2018.

A small number of large-value claims can significantly affect the Fund's operations and cash flow. Both the uncertainty and long-term nature of medical malpractice claims make it difficult to predict if or when large claims will be settled and paid from the Fund. As a result, total annual claim payments can fluctuate from year to year and sufficient reserves need to be set aside to ensure funds are available to pay these claims.

Accurately estimating loss liabilities is challenging for several reasons.

To estimate the amount of reserves that needs to be set aside to pay potential claims, the Fund uses an actuary to project the estimated loss liabilities for medical malpractice incidents that have occurred but may not yet have been settled or even reported. The estimated loss liabilities include an additional risk margin of 25.0 percent to account for the uncertainties related to the estimates. The Board of Governors relies on the Fund's actuary to help estimate loss liabilities and it contracts for actuarial audits to assess the reasonableness of the methodology and assumptions used by the actuary in developing the estimated loss liabilities. The most recent actuarial audit examined the actuarial reports issued for the years ended September 30, 2016, and September 30, 2017, and found the methods and assumptions used conformed with generally accepted actuarial standards and practices. Accurately estimating the Fund's loss liabilities is challenging because:

- secondary medical malpractice insurance claims typically are infrequent and involve severe cases;
- a medical malpractice claim may be filed years after an incident occurred;
- there is no limit on the amount of economic losses the Fund may be required to pay;
- legislation and court decisions can significantly affect the Fund's loss liabilities; and
- the methodology and assumptions used by an actuary can significantly affect the result of an analysis.

The Fund's estimated loss liabilities decreased and were $366.5 million as of June 30, 2018.

The Fund's actuary reviews and revises total loss liability estimates each year, based on an additional year of claims experience and other information. Because the actual claims experience has been more favorable than originally expected, the actuary has regularly reduced the estimate of the Fund's loss liabilities over the past several years, as shown in Table 3. For example, reported estimated loss liabilities to cover future claim payments decreased from $675.4 million as of June 30, 2009, to $366.5 million as of June 30, 2018. Due to the significant uncertainties involved, the actuarial estimates are emphasized in our unmodified audit opinion on the Fund's financial statements.

Table 3

Total Estimated Loss Liabilities
As of June 30
(in millions)

Year	Total Estimated Loss Liabilities	Percentage Change
2009	$675.4	–
2010	721.1	6.8%
2011	636.5	(11.7)
2012	665.8	4.6
2013	628.0	(5.7)
2014	596.5	(5.0)
2015	486.0	(18.5)
2016	424.5	(12.7)
2017	357.1	(15.9)
2018	366.5	2.6

The change in the estimated loss liability each year also affects the underwriting expenses reported on the financial statements each year. Absent other changes, as the estimated loss liabilities decrease, so too do underwriting expenses decrease. This may result in the reporting of a negative expense on the financial statements that improves the Fund's net position. For example, total underwriting expenses were ($58.2) million for FY 2016-17 and ($51.7) million for FY 2015-16, which were reported on the Statement of Revenues, Expenses, and Changes in Fund Net Position. Underwriting expenses were $22.3 million for FY 2017-18 and reflect the small increase in the estimated loss liability as of June 30, 2018.

Annual Assessments

Assessment rates vary by provider type and specialty area.

To cover claims against the Fund, participating providers pay annual assessments based on their type and specialty area. For example, among individual providers, assessment rates are higher for physicians than for nurses, and are higher for physicians who perform surgery than for those who do not. Physicians were assessed rates for FY 2017-18 coverage that ranged from $424 for general practice physicians to $2,798 for obstetric and neurological surgeons.

The Board of Governors has decreased assessment rates in each of the past five fiscal years.

In consultation with the Fund's actuary, and within established statutory limits, the Board of Governors attempts to set annual assessment rates so that the assessments for the period of insurance coverage will cover the ultimate claims that are associated with events that occurred during the same period of insurance coverage. In establishing assessment rates, the Board also considers the Fund's financial position, its cash flow needs, and Wisconsin's medical malpractice environment. Because of the Fund's financial position and investment income, the Board of Governors has decreased assessment rates in each of the past five fiscal years, as shown in Table 4. The Board of Governors approved an additional 10.0 percent decrease in assessments for FY 2018-19.

Table 4

Assessment Rates and Revenues

Policy Year	Percentage Change in Provider Assessment Rates	Assessment Revenues
FY 2013-14	(5.0)%	$36,564,407
FY 2014-15	(10.0)	33,735,169
FY 2015-16	(34.0)	22,086,621
FY 2016-17	(30.0)	16,217,175
FY 2017-18	(30.0)	11,399,860

The assessments are no longer sufficient to cover the ultimate claims that are associated with events that occurred during the same period of insurance coverage.

As a result of the decreases in assessment rates, the assessments are no longer sufficient to cover the ultimate claims that are associated with events that occurred during the same period of insurance coverage. For example, the actuary estimated the ultimate claims for events that occurred during FY 2017-18 to be $27.5 million and the assessments for FY 2017-18 were $11.4 million. Decreases in the estimated loss liabilities and positive investment income have enabled this disparity to occur without detriment to the Fund's net position.

Investment Income

As noted, the investment income of the Fund, which was positive in each of the last nine years, contributed to the decrease in assessment rates. As shown in Table 5, the Fund has earned positive investment income in all but one of the last ten years. In each year that positive investment income was earned, the amount earned contributed to an increase in the Fund's net position and accounted for 19 percent or more of the increase in each year.

Table 5

Investment Income
(in millions)

Fiscal Year	Investment Income
2008-09	$ (3.5)
2009-10	67.9
2010-11	54.1
2011-12	67.5
2012-13	30.7
2013-14	86.2
2014-15	30.2
2015-16	72.1
2016-17	48.4
2017-18	22.3

Financial Position of the Fund

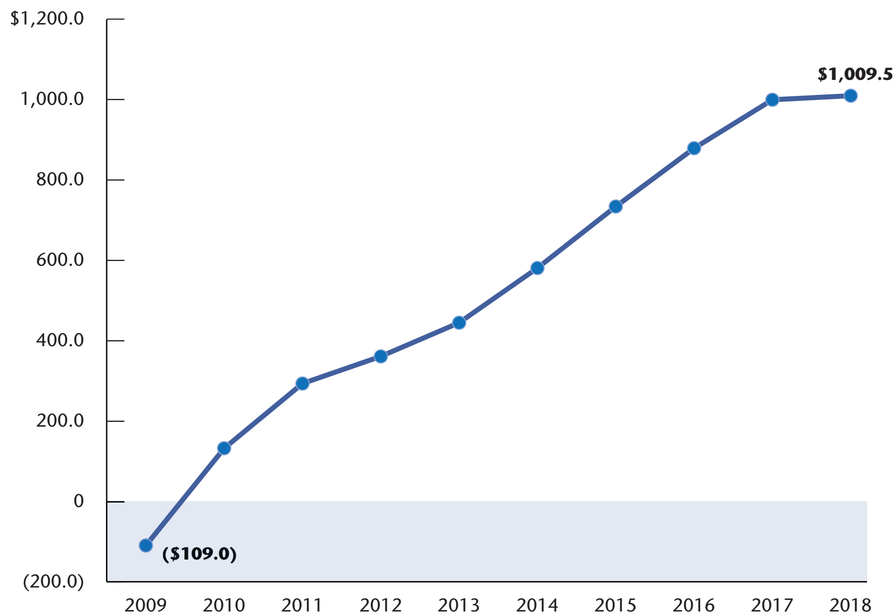
In any insurance operation, a positive financial position is important to ensure adequate resources are available to pay unexpected claims. The uncertainties associated with the long-term nature of the Fund as a secondary medical malpractice insurer increase the importance of maintaining a positive financial position. Although their interests and priorities differ, health care providers, users of health care services, and attorneys in malpractice cases all benefit by having confidence in the reliability and soundness of the Fund's financial operations. To assist in managing the Fund's financial position, which is represented by its net position, the Board of Governors, with the help of the Fund's actuary, established a method for determining an annual target range for the Fund's net position.

The Fund had a net position of $1.0 billion as of June 30, 2018.

A positive net position indicates that sufficient assets have been set aside to fully fund the estimated loss liabilities and other liabilities. As shown in Figure 1, from FY 2008-09 through FY 2017-18, the Fund's net position increased steadily from ($109.0) million as of June 30, 2009, to $1.0 billion as of June 30, 2018. This exceeded the $353.5 million maximum of the target range for the Fund's net position in the September 30, 2017 actuarial report.

Figure 1

Net Position
As of June 30
(in millions)



Over the past five years, the increase in the Fund's net position was driven primarily by positive investment income and decreasing estimated loss liabilities.

The Fund's net position is affected by factors including its assessments, investment income, and underwriting expenses, which primarily consists of changes to its estimated loss liabilities. As noted, in general over the past 10 years the Fund's investment income has been positive and its estimated loss liabilities have decreased. Combined, these factors substantially contributed to the increase in the Fund's financial position. Further, because the Board of Governors has limited control of these factors, the actions it has taken to decrease assessment rates in order to reduce the Fund's net position toward the target range have been unsuccessful. For example, in the past five fiscal years the increase in the Fund's net position was driven primarily by positive investment income and decreasing estimated loss liabilities and not by assessments, which declined during this period.

The Board of Governors has started to re-evaluate the target range for the Fund's net position.

In addition to reducing assessment rates, the Board of Governors has started to re-evaluate the target range for the Fund's net position by considering factors such as health care costs, the medical malpractice environment, the potential for future litigation related to the Fund's limit for noneconomic damages, and the determination of the estimated loss liabilities. Although the Fund's net position is above the target range, it is important that OCI continue to manage the Fund prudently for the benefit of both the participating providers and the claimants. To further support the prudent management of the Fund, it is important that the Board of Governors complete its re-evaluation of the target range for the Fund's net position. During future audits, we will continue to monitor the efforts of OCI and the Board of Governors in this area.

☑ Recommendation

We recommend the Office of the Commissioner of Insurance work with the Board of Governors to:

- *develop a formal written plan for re-evaluating the target range for the Fund's net position, including the anticipated steps needed to complete the re-evaluation;*
- *specify an estimated completion date for each step;*
- *provide updates on the progress of the re-evaluation as part of the annual functional and progress report required by s. 655.27 (4) (f), Wis. Stats., including the results and determinations upon completion of the re-evaluation; and*
- *provide a copy of the annual functional and progress report to the Joint Legislative Audit Committee.*

Internal Control over Financial Reporting

We make recommendations for OCI to improve the financial reporting process for the Fund.

In our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 51, we report significant deficiencies in internal control related to the financial reporting process for FY 2015-16 and FY 2017-18 and make recommendations for improvement. For FY 2015-16, we also report a significant deficiency in internal control over cash reconciliations at the Department of Administration (DOA). The Fund relies on these controls at DOA.

■ ■ ■ ■

Audit Opinion ■

STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Mark V. Afable, Commissioner
Office of the Commissioner of Insurance

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Injured Patients and Families Compensation Fund of the State of Wisconsin as of and for the years ended June 30, 2018, June 30, 2017, and June 30, 2016, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the Injured Patients and Families Compensation Fund 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, which is issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 the 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 opinion on these financial statements.

Opinion

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Injured Patients and Families Compensation Fund as of June 30, 2018, June 30, 2017, and June 30, 2016, and the respective changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphases of Matter

As discussed in Note 1 to the financial statements, the financial statements referred to in the first paragraph present only the Injured Patients and Families Compensation Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin as of June 30, 2018, June 30, 2017, and June 30, 2016, the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with the accounting principles generally accepted in the United States of America.

As discussed in Note 4 to the financial statements, the Injured Patients and Families Compensation Fund's projected ultimate loss liabilities are estimates based on recommendations of a consulting actuary. The Injured Patients and Families Compensation Fund's Board of Governors and management believe that the estimated loss liabilities are reasonable and represent the most probable estimates of the losses the Fund will pay for the claims incurred as of the end of each fiscal year. Uncertainties inherent in projecting the frequency and severity of large secondary medical malpractice insurance claims, the Fund's unlimited liability coverage, and extended reporting and settlement periods make it likely that amounts paid will ultimately differ from the reported estimated liabilities. These differences cannot currently be quantified.

As discussed in Note 3 to the financial statements, the Injured Patients and Families Compensation Fund implemented Governmental Accounting Standards Board Statement Number 72, *Fair Value Measurement and Application*, which addresses accounting and reporting issues related to fair value measurements.

Our opinion is not modified for any of the above matters.

Other Matter

Required Supplementary Information—Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 19 through 27 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated May 29, 2019, on our consideration of the Injured Patients and Families Compensation Fund's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, contracts; and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the Injured Patients and Families Compensation Fund's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

May 29, 2019

Management's Discussion and Analysis ▪

Prepared by Management of the Wisconsin Injured Patients and Families Compensation Fund

This section presents Management's Discussion and Analysis of the financial performance of the Wisconsin Injured Patients and Families Compensation Fund during the fiscal years ended June 30, 2018, June 30, 2017, and June 30, 2016. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the management of the Fund.

Overview of the Fund

The Fund, formally known as the Injured Patients and Families Compensation Fund, was created in 1975 to provide excess medical malpractice insurance for Wisconsin health care providers. Under broad authority granted to it by s. 655.27(2), Wis. Stats., the Fund is governed by a 13-member Board of Governors. The Board consists of three insurance industry representatives appointed by the Commissioner of Insurance; a member named by the Wisconsin Association for Justice; a member named by the State Bar of Wisconsin; two members named by the Wisconsin Medical Society; a member named by the Wisconsin Hospital Association; four public members appointed by the Governor; and the Commissioner of Insurance, who serves as the chair. The Fund's administrative staff is provided by the Office of the Commissioner of Insurance.

The Board is assisted by its Actuarial and Underwriting Committee; Legal Committee; Claims Committee; Finance, Investment, and Audit Committee; Risk

Management and Patient Safety Committee; and Peer Review Council. The Board and its committees meet quarterly.

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

Financial Statements

The Fund's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Financial statements for each of the past three fiscal years follow this discussion and analysis. Only significant sections of the financial statements are discussed in the following pages.

Assets

The Fund's assets consist primarily of investments, which are managed as part of the State of Wisconsin Investment Board's government portfolios, which include various portfolios. Wisconsin Statutes, program policy provisions, appropriate governing bonds, and general resolutions contained in revenue bond indenture documents define the types of securities authorized as appropriate investments and the conditions for making investment transactions. The Board of Governors and its Finance, Investment, and Audit Committee provide oversight through statutory guidelines in the investment structure of the Fund's portfolio. Compliance with these guidelines is reviewed quarterly by the Finance, Investment, and Audit Committee.

The Fund's investment strategy is to invest at least 75.0 percent of its assets in fixed-income securities that have a reasonable degree of safety of principal, as well as income-paying ability. The rest may be invested in equities or as a cash reserve with a maximum of 20.0 percent being in equities. High priority is given to matching the maturity of assets with the liquidity needs of the liabilities. Equities made up 16.7 percent of total investments as of June 30, 2018, 14.8 percent as of June 30, 2017, and 17.4 percent as of June 30, 2016. Consequently the Fund remained in compliance with the investment guideline that limits equities to no more than 20.0 percent of total investments. Investments are reported at fair value.

As shown in Table A, there have been increases in total assets over the last three years. Total assets for the Fund are primarily comprised of investments which increased from $1.22 billion as of June 30, 2015, to $1.32 billion as of June 30, 2016, $1.37 billion as of June 30, 2017, and over $1.39 billion as of June 30, 2018. The increases are primarily attributed to gains on investments.

Table A

Total Assets
As of June 30

Year	Total Assets	Percentage Change from Prior Year
2018	$1,391,504,388	1.3%
2017	1,373,390,232	4.4
2016	1,315,948,494	7.5
2015	1,224,008,967	–

Loss Liabilities

Loss liabilities are the amounts expected to be paid in the future for incidents that have already occurred, and they account for nearly all the liabilities of the Fund. Total loss liabilities, which are shown in Table B, include the total of individual case estimates for reported losses, the actuarially determined estimate for losses that have been incurred but have not yet been reported to the Fund, and provisions for the estimated future payment of loss adjustment costs associated with the outstanding claims, future investment earnings, accounts managed by the Fund for future medical expenses, and contributions from the primary insurer on a current claim. The expressed amounts of loss liabilities in Table B include current and noncurrent portions.

Table B

Total Loss Liabilities
As of June 30

Year	Total Loss Liabilities	Percentage Change from Prior Year
2018	$366,549,593	2.6%
2017	357,113,048	(15.9)
2016	424,482,782	(12.7)
2015	486,038,973	–

Changes in loss liabilities from one year to the next reflect a combination of another year's loss experience, plus or minus any change to prior years' loss liability estimates based on actuarial studies. The uncertainties inherent in projecting the frequency and severity of claims because of the Fund's unlimited liability coverage for economic damages, extended reporting and settlement periods, and the effect of court decisions and legislative initiatives make it likely that the amounts ultimately paid will differ from the reported estimated liabilities. These differences cannot be quantified. The estimated amounts included in the balance of Future Benefits and Loss Liabilities 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, the benefit expense for the fiscal year is not necessarily indicative of the loss experience for the year. The Fund's actuary performs an annual review of the outstanding estimated liabilities for each year and makes adjustments for each year as deemed appropriate.

The loss liabilities can also be affected by the interest rate assumption and corresponding discount factor used in determining their present value, as required by Wisconsin Administrative Code. Changes in the discount factor, as well as the amount of the estimated loss liabilities and available assets, affect the contra liability account—amount representing interest—and the change in that account, which is reflected as an underwriting expense. The Board of Governors decreased the investment assumption from 4.5 percent to 4.0 percent effective for the loss liabilities as of June 30, 2016 and June 30, 2017, and from 4.0 percent to 2.0 percent effective for the loss liabilities as of June 30, 2018, which has an effect of increasing the present value of the loss liabilities. The investment rate assumptions resulted in discount factors of 0.934 for FY 2017-18, 0.869 for FY 2016-17, and 0.862 for FY 2015-16.

Net Position

The Fund's net position, which is the assets plus deferred outflows less the liabilities and deferred inflows, for the past four years are shown in Table C. The changes in net position are largely attributable to the difference between revenues earned and expenses incurred; changes made to loss liability estimates for previous years as determined by the actuary; and unrealized investment gains and losses, which reflect changes in the fair value of held investments.

Table C

Net Position
As of June 30

Year	Net Position	Percentage Change from Prior Year
2018	$1,009,527,768	1.0%
2017	999,496,722	13.7
2016	878,876,683	19.8
2015	733,852,348	–

The Fund's net position increased from June 30, 2015, to June 30, 2016, by $145.0 million from $733.9 million at June 30, 2015, to $878.9 million at June 30, 2016. The increase in net position from June 30, 2016 to June 30, 2017 was $120.6 million and the increase from June 30, 2017 to June 30, 2018 was $10.0 million. The increase of net position for the years represented is primarily comprised of investment income, along with favorable development of the claims paid and a decrease in the loss liabilities.

Revenues

The Fund's revenues consist primarily of assessments and investment income. All Fund participants are billed annually in accordance with an assessment rate determined by the Board of Governors. Investment income varies for reasons that include the economy in general, the operating experience of the Fund, and the amount of new money available for investing.

As shown in Table D, total revenues increased significantly from FY 2014-15 to FY 2015-16, from $64.0 million to $94.3 million as a result of increased investment income. Total revenue decreased in FY 2016-17 by $29.7 million and for FY 2017-18 by $30.8 million. This decrease was due to a decline in assessments revenue attributed to a reduction in assessment rates of 34.0 percent for FY 2015-16 and 30.0 percent for each FY 2016-17 and FY 2017-18 and an overall decrease in investment income during the three-year time period.

Table D

Total Revenues

Fiscal Year	Total Revenues	Percentage Change from Prior Year
2017-18	$33,782,252	(47.7)%
2016-17	64,624,612	(31.5)
2015-16	94,277,706	47.3
2014-15	64,008,014	–

Assessment revenues, which are shown in Table E, depend on the number of each type of provider participating in the Fund and the assessment rates in effect for each provider type. The Board of Governors authorized changes in assessment rates as follows: a 34.0 percent decrease for FY 2015-16, a 30.0 percent decrease for FY 2016-17, and a 30.0 percent decrease for FY 2017-18. Total assessments can fluctuate at a rate somewhat different than the approved rate change because of variances in the number and classification of providers.

Table E

Assessment Revenues

Fiscal Year	Assessment Revenues	Percentage Change from Prior Year
2017-18	$11,399,860	(29.7)%
2016-17	16,217,175	(26.6)
2015-16	22,086,621	(34.5)
2014-15	33,735,169	–

Physicians are classified into one of four classes based upon a risk assessment of their specialty. Hospitals are assessed based upon the number of beds and outpatient visits. As shown in Table F, as of June 30, 2018, Fund participants were mostly physicians.

Table F

Providers by Type
As of June 30, 2018

Provider Type	Number of Providers	Percentage of Total Providers
Physicians	14,563	86.7%
Corporations	1,151	6.8
Nurse Anesthetists	824	4.9
Hospitals	144	0.9
Partnerships	16	0.1
Hospital-affiliated Nursing Homes	18	0.1
Hospital-owned or -controlled Entities	16	0.1
Ambulatory Surgery Centers	74	0.4
Cooperatives	1	0.0
Total	**16,807**	**100.0%**

Investment income, which includes fixed-income portfolio interest, stock dividends, and investment gains and losses is shown in Table G. The Fund earned interest income ranging from $24.8 million to $42.9 million over the four-year period from its debt securities. Annual investment income can also be significantly affected by changes in unrealized gains and losses associated with changes in the fair value of the Fund's investments, which can be affected by the Fund's experience in the equities market, changes in the ratings within the fixed-income portfolio, and changes in the interest rate environment. The Fund recognized unrealized investment losses of $9.7 million in FY 2017-18 and $107.7 million in FY 2016-17, and unrealized investment gains of $10.8 million in FY 2015-16.

Table G

Investment Income

Fiscal Year	Investment Income	Percentage Change from Prior Year
2017-18	$22,345,190	(53.8)%
2016-17	48,359,862	(33.0)
2015-16	72,144,662	138.9
2014-15	30,200,545	–

Underwriting Expenses

The Fund's underwriting expenses, which are shown in Table H, consist of loss and loss adjustment expenses paid, plus changes to the liabilities for unpaid claims. The changes to the liabilities can be either positive or negative amounts, depending upon the annual actuarial analysis of the outstanding loss liabilities on a year-by-year basis.

Table H

Underwriting Expenses

Fiscal Year	Underwriting Expenses	Percentage Change from Prior Year
2017-18	$22,251,073	(138.2)%
2016-17	(58,187,808)	12.5
2015-16	(51,712,514)	(42.1)
2014-15	(89,359,050)	–

The major cause of the significant changes in the underwriting expenses are changes in actuarial projections related to the outstanding liabilities for unpaid losses and loss adjustment expenses. In addition, any changes to the interest rate used in the discounting of the loss liabilities, such as the decrease to 2.0 percent in FY 2017-18, will flow through to the underwriting expenses.

In FY 2015-16 and FY 2016-17, the Fund reported negative underwriting expenses each year in total, because decreases to total loss liability estimates were greater than increases. The Fund reduced its loss liability estimates from prior years considering additional claims experience with lower years of claim payments. The liability includes an explicit risk margin that is established to ensure that loss liabilities will remain adequate in the event a court decision or law change could adversely affect the amount of future claim payments. In FY 2017-18 the Fund reported positive underwriting expenses in total, because of the change in the interest rate used in the discounting of the loss liability from 4.0 percent to 2.0 percent and for the actuarial projection.

Summary

The Wisconsin Injured Patients and Families Compensation Fund, a segregated fund administered by the Office of the Commissioner of Insurance, operates as a risk-sharing fund. Assessments are collected from participating health care providers and are used to pay underwriting and administrative expenses. The Fund's Board of Governors determines the assessment rates annually, based on actuarial advice. While the investments of the Fund currently can be used to meet current claim obligations, the Board is closely monitoring the revenues, assets, and net position of the Fund.

Investments are predominantly conservative (approximately 80.0 percent in fixed-income securities and 20.0 percent in equities), with the intent to match assets with liabilities while maximizing return.

Contacting the Fund's Financial Management

This financial report is designed to provide the Legislature, the executive branch of government, the Board of Governors, the public, and other interested parties with an overview of the financial results of the Fund's activities and to show the Fund's financial position. If you have questions about this report or need additional information, contact the director of the Wisconsin Injured Patients and Families Compensation Fund at:

Office of the Commissioner of Insurance
125 South Webster Street
P.O. Box 7873
Madison, Wisconsin 53707-7873

■ ■ ■ ■

Financial Statements ■

Statement of Net Position
June 30, 2018, June 30, 2017, and June 30, 2016

	June 30, 2018	June 30, 2017	June 30, 2016
ASSETS			
Current Assets:			
Cash and Cash Equivalents (Note 3)	$ 21,189,638	$ 31,319,811	$ 26,076,489
Investments (Note 3)	20,709,173	7,531,518	0
Investment Income Receivable	22,031,601	17,101,890	18,881,191
Advance to the Medical Assistance Trust Fund	50,000	0	0
Assessments Receivable	0	38,948	143,966
Other Assets	1,432	1,059	11,421
Total Current Assets	63,981,844	55,993,226	45,113,067
Noncurrent Assets:			
Investments (Note 3)	1,295,108,314	1,284,331,332	1,237,466,256
Advance to the Mediation Fund	0	50,000	0
Restricted Cash and Cash Equivalents (Note 3)	31,401,156	32,025,391	32,338,520
Other Restricted Assets	99,545	0	0
Capital Assets, Net of Accumulated Depreciation	913,529	990,283	1,030,651
Total Noncurrent Assets	1,327,522,544	1,317,397,006	1,270,835,427
Total Assets	**1,391,504,388**	**1,373,390,232**	**1,315,948,494**
Deferred Outflow of Resources	**175,864**	**191,329**	**287,748**
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	**1,391,680,252**	**1,373,581,561**	**1,316,236,242**
LIABILITIES			
Current Liabilities:			
Loss Liabilities—Current Portion (Note 4)	68,822,000	58,661,000	52,261,840
Assessments Received in Advance	1,234,881	1,658,850	2,089,470
Provider Refunds Payable	1,202,725	1,395,555	1,938,597
General and Administrative Expense Payable	115,436	114,805	102,614
Investment Purchases Payable	12,497,055	13,546,874	8,066,794
Other Liabilities	11,092	14,863	412,791
Medical Mediation Panel Fees Payable (Note 5)	142,234	29,522	10,164
Total Current Liabilities	**84,025,423**	**75,421,469**	**64,882,270**
Noncurrent Liabilities:			
Loss Liabilities (Note 4):			
Loss Liability for Incurred but not Reported Losses	259,326,058	303,473,257	365,972,002
Loss Liability for Reported Losses	33,495,486	14,696,660	20,999,466
Loss Liability for Loss Adjustment Expense	65,863,113	54,632,258	66,838,413
Estimated Loss Liabilities	358,684,657	372,802,175	453,809,881
Amount Representing Interest	(23,536,220)	(48,714,519)	(62,665,619)
Discounted Loss Liabilities	335,148,437	324,087,656	391,144,262
Liability Contributions Being Held	0	1,000,000	1,000,000
Liabilities for Future Medical Expense	31,401,156	32,025,392	32,338,520
Total Loss Liabilities	366,549,593	357,113,048	424,482,782
Less: Loss Liabilities—Current Portion	(68,822,000)	(58,661,000)	(52,261,840)
Noncurrent Loss Liabilities	297,727,593	298,452,048	372,220,942
Compensated Absences and OPEB Liabilities	193,210	124,945	141,751
Total Noncurrent Liabilities	297,920,802	298,576,993	372,362,693
Total Liabilities	**381,946,226**	**373,998,462**	**437,244,963**
Deferred Inflow of Resources	**206,258**	**86,377**	**114,596**
TOTAL LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	382,152,484	374,084,839	437,359,559
NET POSITION			
Net Position (Note 2I):			
Invested in Capital Assets	913,529	990,283	1,030,651
Restricted for Other Purposes	99,545	0	0
Restricted for Injured Patients and Families	**1,008,514,694**	**998,506,439**	**877,846,032**
TOTAL NET POSITION	**$ 1,009,527,768**	**$ 999,496,722**	**$ 878,876,683**

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Position for the Years Ended June 30, 2018, June 30, 2017, and June 30, 2016

	Year Ended June 30, 2018	Year Ended June 30, 2017	Year Ended June 30, 2016
OPERATING REVENUES			
Assessments	$ 11,399,860	$ 16,217,175	$ 22,086,621
Assessment Interest and Administrative Fee Income	30,447	29,323	32,140
Total Operating Revenues	**11,430,307**	**16,246,498**	**22,118,761**
OPERATING EXPENSES			
Underwriting Expenses:			
Net Losses Paid	6,816,493	4,032,764	2,851,174
Loss Adjustment Expenses Paid	3,591,301	3,586,070	4,277,120
Risk Management Expenses	65,159	74,828	27,319
Medical Expenses Paid	1,341,575	1,488,264	1,688,065
Change in Liability for Incurred but not Reported Losses	(44,147,199)	(62,498,745)	(75,035,771)
Change in Liability for Reported Losses	18,798,826	(6,302,806)	16,998,565
Change in Liability for Loss Adjustment Expense	11,230,855	(12,206,155)	(13,576,363)
Change in Amount Representing Interest	25,178,299	13,951,100	17,074,361
Change in Liability for Future Medical Expense	(624,236)	(313,128)	(6,016,984)
Total Underwriting Expenses	22,251,073	(58,187,808)	(51,712,514)
General and Administrative Expenses	1,414,739	1,434,105	951,206
Total Operating Expenses	**23,665,812**	**(56,753,703)**	**(50,761,308)**
OPERATING INCOME (LOSS)	**(12,235,505)**	**73,000,201**	**72,880,069**
NONOPERATING REVENUES (EXPENSES), AND TRANSFERS			
Investment Income	22,345,190	48,359,862	72,144,662
Miscellaneous Revenue (Expense)	6,755	18,252	14,283
Net Income Before Transfers	10,116,440	121,378,315	145,039,014
Transfers:			
Transfers to the General Fund	(13,643)	(17,456)	(14,679)
CHANGE IN NET POSITION	**10,102,797**	**121,360,859**	**145,024,335**
NET POSITION			
Net Position—Beginning of the Year	999,496,722	878,876,683	733,852,348
Prior Period Adjustment	(71,751)	(740,820)	0
Net Position—End of the Year	$ 1,009,527,768	$ 999,496,722	$ 878,876,683

The accompanying notes are an integral part of this statement.

Statement of Cash Flows
for the Years Ended June 30, 2018, June 30, 2017, and June 30, 2016

	Year Ended June 30, 2018	Year Ended June 30, 2017	Year Ended June 30, 2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Received from Providers for Assessments	$ 11,587,154	$ 16,365,111	$ 22,909,505
Cash Received from Other Sources	0	0	22,184
Cash Paid for Losses	(7,761,422)	(4,032,764)	(3,851,174)
Cash Paid for Loss Adjustment Expenses	(3,591,301)	(3,586,070)	(4,277,120)
Cash Paid for Future Medical Expenses	(1,440,983)	(1,488,264)	(1,688,065)
Cash Paid for Other Expenses	(997,342)	(1,155,904)	(662,128)
Cash Paid to Providers for Refunds of Assessments	(382,158)	(724,125)	(300,003)
Cash Paid for Medical Mediation Panel Fees	(188,903)	(168,844)	(216,281)
Net Cash Provided by (Used for) Operating Activities	**(2,774,955)**	**5,209,141**	**11,936,918**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Transfers to the General Fund	(13,643)	(17,456)	(14,679)
Net Cash Provided by (Used for) Noncapital Financing Activities	**(13,643)**	**(17,456)**	**(14,679)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Cash Paid to Develop the Fund's Provider System	(447,269)	(312,662)	(372,408)
Net Cash Provided by (Used for) Capital and Related Financing Activities	**(447,269)**	**(312,662)**	**(372,408)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest Received	33,993,144	32,337,167	33,987,546
Cash Received as Proceeds from Sales of Investments	211,809,190	495,567,806	944,722,613
Cash Paid for Purchase of Investment Securities	(253,320,876)	(527,853,801)	(989,206,444)
Net Cash Provided by (Used for) Investment Activities	**(7,518,542)**	**51,172**	**(10,496,285)**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(10,754,409)**	**4,930,195**	**1,053,545**
Cash and Cash Equivalents—Beginning of the Year	63,345,203	58,415,008	57,361,463
Cash and Cash Equivalents—End of the Year	$ 52,590,794	$ 63,345,202	$ 58,415,009

The accompanying notes are an integral part of this statement.

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	Year Ended June 30, 2018	Year Ended June 30, 2017	Year Ended June 30, 2016
Operating Income	$ (12,235,505)	$ 73,000,201	$ 72,880,069
Adjustments to Reconcile Operating Income to			
Net Cash Provided by Operating Activities:			
Depreciation Expense	524,023	353,030	213,841
Miscellaneous Nonoperating Income (Expense)	0	18,252	14,283
Changes in Assets and Liabilities:			
Decrease (Increase) in Assessments Receivable	38,948	105,018	133,872
Decrease (Increase) in Advance to Other Funds	0	(50,000)	0
Decrease (Increase) in Other Assets	(99,920)	161	15,048
Increase (decrease) in Deferred Inflows of Resources	119,880	(28,219)	113,534
Decrease (increase) in Deferred Outflows of Resources	15,465	96,419	(149,633)
Increase (Decrease) in Loss Liabilities	9,436,545	(67,369,734)	(61,556,193)
Increase (Decrease) in Other Liabilities	(574,394)	(915,987)	272,095
Total Adjustments	9,460,547	(67,791,060)	(60,943,153)
Net Cash Provided by (Used for) Operating Activities	**$ (2,774,958)**	**$ 5,209,141**	**$ 11,936,916**
Noncash Activities:			
Net Change in Unrealized Gains (Losses)	$ (9,707,148)	$ (107,671,390)	$ 10,830,181
Amortization of Bond Discounts	(4,053,982)	(5,116,936)	(4,337,471)

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ▪

1. DESCRIPTION OF THE FUND

The Injured Patients and Families Compensation Fund is part of the State of Wisconsin financial reporting entity and is reported as a major enterprise fund in the State's basic financial statements, which are included in the State's Comprehensive Annual Financial Report. The Fund, formerly 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. Stats., 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. Stats., 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 FY 2017-18, FY 2016-17 and FY 2015-16, 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 Injured Patients and Families Compensation Fund have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). 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 nonoperating. Because the Fund is an enterprise fund, which also is a type of proprietary fund, it accounts for its activities similar to that of a private businesses. Enterprise funds provide goods or services to the general public for a fee. 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 are reported as nonoperating revenues and expenses. The most significant source of the Fund's nonoperating income is investment income, while operating revenue consists of assessment income.

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. Balances pooled in the State Investment Fund are restricted to legally stipulated investments valued consistent with GASB Statement 72.

D. Investment Valuation

Investments of the Fund consist of fixed-income securities, preferred 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 unearned 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 reported 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 a historic cost or estimated historic cost in excess of $5,000 and a useful life of two or more years. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund's capital assets consisted of one asset, the internally developed provider system software that is depreciated on a straight-line basis over fifteen years.

I. Net Position

Section 655.27 (6), Wis. Stats., requires the Injured Patients and Families Compensation Fund to be held in an irrevocable trust and used for future claim payments for injured patients and families. For the three-year period, net position totaled $1,009,527,768 as of June 30, 2018, $999,496,722 as of June 30, 2017, and $878,876,683 as of June 30, 2016, and was primarily restricted for injured patients and families.

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 postemployment 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. DEPOSITS AND INVESTMENTS

The Fund's deposits consist of cash deposited in the State's bank, which totaled $3,715 as of June 30, 2018, $16,648 as of June 30, 2017, and $58,543 as of June 30, 2016.

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. Stats., allows investments in loans, securities, and any other investments as authorized by s. 620.22, Wis. Stats. Classes of investments permitted by s. 620.22, Wis. Stats., 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 percent of the Fund's total portfolio.

Although classified as cash and cash equivalents on the Statement of Net Position 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. Stats., 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.

Investments of the Fund are governed by chs. 655 and 620 of Wis. Stats., which limits the type of investments in which funds may be invested. Wisconsin Statutes provides the necessary framework for the implementation of GASB Statement No. 72, which was implemented effective for FY 2015-16.

This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement also provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of an asset. Level 1 inputs are quoted prices in active markets for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs.

The Fund has the following recurring fair value measurements for the Fund's investments noted in the tables entitled Investments Measured at Fair Value as of June 30, 2018, June 30, 2017, and June 30, 2016 respectively:

Investments Measured at Fair Value as of June 30, 2018 ($ in millions)		Fair Value Measurements Using		
	Total as of June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by Fair Value Level:				
U.S. Government and Agency Bonds	$ 597.9	$0.0	$ 597.9	$0.0
Municipal Bonds	21.1	0.0	21.1	0.0
Foreign Governments	40.6	0.0	40.6	0.0
Corporate Bonds	428.1	0.0	428.1	0.0
Total Investments by Fair Value Level	$1,087.7	$0.0	$1,087.7	$0.0
Investments valued at Net Asset Value (NAV):				
Equity Index Funds	$ 228.1			
State Investment Fund	44.2			
Short-Term Investment Fund	8.4			
Total Investments by NAV	$ 280.7			
Total Investments	$1,368.4			

Investments Measured at Fair Value as of June 30, 2017 ($ in millions)		Fair Value Measurements Using		
	Total as of June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by Fair Value Level:				
U.S. Government and Agency Bonds	$ 575.0	$16.3	$ 558.7	$0.0
Municipal Bonds	25.5	0.0	25.5	0.0
Foreign Governments	22.3	0.0	22.3	0.0
Corporate Bonds	466.9	0.0	466.9	0.0
Preferred Securities	1.6	0.0	1.6	0.0
Total Investments by Fair Value Level	$1,091.3	$16.3	$1,075.0	$0.0
Investments valued at Net Asset Value (NAV):				
Equity Index Funds	$ 200.6			
State Investment Fund	48.3			
Short-Term Investment Fund	15.1			
Total Investments by NAV	$ 264.0			
Total Investments	$1,355.3			

Investments Measured at Fair Value as of June 30, 2016 ($ in millions)		Fair Value Measurements Using		
	Total as of June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by Fair Value Level:				
U.S. Government and Agency Bonds	$ 528.8	$1.0	$ 527.8	$0.0
Municipal Bonds	27.9	0.0	27.9	0.0
Foreign Governments	23.5	0.0	23.5	0.0
Corporate Bonds	430.2	0.0	430.2	0.0
Preferred Securities	1.6	0.0	1.6	0.0
Total Investments by Fair Value Level	$1,012.0	$1.0	$1,011.0	$0.0
Investments valued at Net Asset Value (NAV):				
Equity Index Funds	$ 224.9			
State Investment Fund	51.6			
Short-Term Investment Fund	6.6			
Total Investments by NAV	$ 283.1			
Total Investments	$1,295.1			

Debt securities categorized as Level 2 are valued by third party pricing services using a matrix-pricing technique that values securities based on their relationship to quoted market prices for securities with similar interest rates, maturities, and credit ratings.

The fair values of investments in commingled equity index funds are based on the investment's net asset value (NAV) per share (or its equivalent), as of fiscal years ending June 30, 2018, June 30, 2017, and June 30, 2016. The trustees roll pricing of the underlying investments designed to track the performance of the given indices into the NAV. There were no unfunded commitments relating to these funds for the periods described.

The equity index funds are invested in portfolios of equity securities with the objective of approximating as closely as practicable the capitalization weighted total rate of return of a given segment of the U.S. or international markets for publicly traded equity securities. The U.S. equity index fund is invested in a portfolio of equity securities with the objective of approximating the 3,000 largest capitalized companies (the Russell 3000R Index). The investment can be redeemed daily with one day's notice. The international equity fund is invested in a portfolio of equity securities with the objective of approximating the MSCI World ex USA Net Dividend Return Index for the country or countries represented. The investment can be redeemed daily with two days' notice.

The fair value of the investments in the State Investment Fund, a pooled short-term investment fund managed by the State of Wisconsin Investment Board, is based on NAV per share (or its equivalent) as of fiscal years ending June 30, 2018, June 30, 2017, and June 30, 2016. The State Investment Fund is a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. The valuation of the underlying investments of the State Investment Fund depends on asset class. Repurchase Agreements and non-negotiable Certificates of Deposit are valued at cost. All remaining short-term investments (U.S. Government/Agency securities, Banker's Acceptances, Commercial Paper, and negotiable Certificates of Deposit) are carried at fair value. Because quoted market prices for State Investment Fund securities are often not available, at month end, BNY Mellon, as SWIB's custodial bank, compiles fair values from third party pricing services which use matrix pricing models to estimate a security's fair value. There are no unfunded commitments relating to the State Investment Fund, and shares of this fund can be fully redeemed at any time with no notice or other restrictions.

The fair value of the investment in the Short-Term Investment Fund (STIF), a pooled investment fund, is based on NAV per share (or its equivalent), as of the periods described. The STIF is a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. There are no unfunded commitments relating to the STIF, and shares of the STIF can be fully redeemed at any time with no notice or other restrictions.

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

	June 30, 2018	June 30, 2017	June 30, 2016
Short-term Investment Pool			
State Investment Fund[1]	$ 52,628,760	$ 63,390,067	$ 58,206,467
Fixed Income:			
U.S. Government and Agency	597,918,268	575,021,604	528,767,215
Municipal Bonds	21,047,846	25,515,089	27,921,063
Foreign Governments	40,620,311	22,321,048	23,489,051
Corporate Bonds	428,127,413	466,826,341	430,212,530
Subtotal	1,087,713,838	1,089,684,082	1,010,389,859
Equities:			
MSCI World Ex-US Index Fund	31,960,643	29,822,982	26,689,557
Russell 3000 Index Fund	196,143,006	170,754,337	0
Russell 2000 Index Fund	0	0	16,844,299
S & P 500 Index Fund	0	0	165,877,126
S & P 400 Index Fund	0	0	15,438,271
Subtotal	228,103,649	200,577,319	224,849,253
Preferred Securities	0	1,601,448	1,621,482
Total Investments	$1,368,446,247	$1,355,252,916	$1,295,067,061

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

Custodial Credit Risk for 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. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund had no bank balances exposed to custodial credit risk.

Custodial Credit Risk for 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's investment policy does not address custodial credit risk. The Fund's investment portfolio as of June 30, 2018, June 30, 2017, and June 30, 2016, identified no custodial credit risk exposure.

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Fund. As of June 30, 2018, the Fund's investment guidelines provide that, at the time of purchase, at least 80.0 percent 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 percent 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 for fixed-income securities as of June 30, 2018, June 30, 2017, and June 30, 2016, were as follows:

	June 30, 2018		June 30, 2017		June 30, 2016	
	Fair Value	Percentage	Fair Value	Percentage	Fair Value	Percentage
Credit Rating:						
AAA	$ 27,417,307	2.4%	$ 26,763,316	2.3%	$ 26,968,917	2.5%
AA	631,544,351	55.4	613,379,614	53.2	552,622,283	51.7
A	121,810,827	10.7	130,348,174	11.3	133,228,999	12.5
BBB	275,038,461	24.1	287,145,677	24.9	261,090,179	24.5
BB	31,870,292	2.8	25,792,376	2.3	28,135,743	2.6
B	0	0.0	6,244,475	0.5	7,420,438	0.7
C or Lower	0	0.0	0	0.0	923,000	0.1
Not Rated	32,600	0.0	10,450	0.0	300	0.0
Subtotal	1,087,713,838	95.4	1,089,684,082	94.5	1,010,389,859	94.6
State Investment Fund (unrated)[1]	52,628,760	4.6	63,390,067	5.5	58,206,467	5.4
Total	$1,140,342,598	100.0%	$1,153,074,149	100.0%	$1,068,596,326	100.0%

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

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. As of June 30, 2018, the Fund's investment guidelines do not allow for investments in any one single issuer that are in excess of 5.0 percent of the Fund's bond portfolio based on fair value at the time of purchase. Securities of the United States government and its agencies are excluded from that limitation. As of June 30, 2018, June 30, 2017, and June 30, 2016, the Fund did not have more than 5.0 percent 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. As of June 30, 2018, 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:

	June 30, 2018		June 30, 2017		June 30, 2016	
	Fair Value	Duration (in years)	Fair Value	Duration (in years)	Fair Value	Duration (in years)
Type of Security:						
Government/Agency	$ 597,918,268	5.33	$ 575,021,604	5.21	$ 528,767,215	5.07
Corporate	489,795,570	7.20	514,662,478	7.54	481,622,644	7.78
Subtotal	1,087,713,838	6.17	1,089,684,082	6.30	1,010,389,859	6.36
State Investment Fund[1]	44,204,000	0.05	48,274,000	0.08	51,618,000	0.18
Short-term Investment Fund	8,424,759	0.13	15,116,067	0.16	6,588,467	0.20
Total	$1,140,342,597	5.89	$1,153,074,149	5.97	$1,068,596,326	6.04

[1] State Investment Fund shares are reported as cash and cash equivalents on the Statement of Net Position.

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, 2018, June 30, 2017, and June 30, 2016, the Fund did not own any foreign denominated currency.

4. TOTAL LOSS LIABILITIES

A. Estimated Loss Liabilities

Loss liabilities include individual case estimates for reported losses and estimates for incurred but not reported (IBNR) losses based upon the projected ultimate losses recommended by a consulting actuary as approved by the Board of Governors. The liability for IBNR losses as of June 30, 2018, is determined by deducting individual case estimates of the liability for reported losses and net losses paid from inception of the Fund, and adding a risk margin to the projected ultimate loss liabilities as follows:

	June 30, 2018	June 30, 2017	June 30, 2016
Projected Ultimate Loss Liability	$1,108,669,000	$1,120,611,000	$1,170,603,450
Less:			
Net Losses Paid from Inception	(874,411,765)	(866,075,066)	(861,026,275)
Liability for Reported Losses	(33,495,486)	(14,696,660)	(20,999,466)
Risk Margin	58,564,309	63,633,983	77,394,293
Liability for IBNR Losses	$ 259,326,058	$ 303,473,257	$ 365,972,002

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 percent risk margin to the best estimate for June 30, 2018, June 30, 2017, and June 30, 2016. 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 33.7 percent of the estimated unpaid loss liabilities as of June 30, 2018, 27.7 percent of the estimated unpaid loss liabilities as of June 30, 2017, and 18.0 percent of the estimated unpaid loss liabilities as of June 30, 2016. Because the actuary's estimate occurs before the end of the fiscal year and is based on an estimate of the cumulative payments, the percentage used by the actuary in determining the LAE will differ slightly from the percentages calculated using actual LAE payments in the financial statements. 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, 2018	June 30, 2017	June 30, 2016
Projected Ultimate LAE Liability	$155,691,000	$143,151,000	$149,329,854
Less:			
Net LAE Paid from Inception	(103,000,510)	(99,445,193)	(95,859,123)
Risk Margin	13,172,623	10,926,451	13,367,682
Liability for LAE	$ 65,863,113	$ 54,632,258	$ 66,838,413

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 4.0 percent for FY 2015-16 and FY 2016-17 and 2.0 percent for FY 2017-18 that were approved by the Board of Governors, were 0.862 for FY 2015-16, 0.869 for FY 2016-17, and 0.934 for FY 2017-18.

D. Future Medical Expense Liability

Section 655.015, Wis. Stats., 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. There were no contributions being held as of June 30, 2018, while contributions of $1.0 million were being held as of June 30, 2017, and June 30, 2016.

F. Loss Liabilities Balances and Activities (in thousands)

	FY 2017-18	FY 2016-17	FY 2015-16
Total Loss Liabilities, Beginning of the Year	$357,113	$424,483	$486,039
Incurred Losses and Related Expenses for the Current Year and Changes in the Estimated Liabilities for Prior Year Losses and Related Expenses	22,337	(58,188)	(51,713)
Less: Current Year Payments for Losses, LAE, and FME Incurred in the Current and Prior Years	(12,900)	(9,182)	(9,843)
Total Loss Liabilities, End of the Year	366,550	357,113	424,483
Less: Current Portion	(68,822)	(58,661)	(52,262)
Noncurrent Portion	$297,728	$298,452	$372,221

5. MEDICAL MEDIATION PANEL FEES

Section Ins. 17.27 (3), Wis. Adm. Code, requires the fees collected for administration of the Medical Mediation Panel to 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. The Wisconsin Supreme Court requested panel fees of $280,556 in FY 2017-18, $123,500 in FY 2016-17, and $185,960 in FY 2015-16.

6. 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 and the reassignment company default on annuity payments.

One of the Fund's annuity providers defaulted on $119,863 in annuity payments through June 30, 2018, 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, 2018, the Fund has received a total reimbursement of $114,038, 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, 2018, June 30, 2017, and June 30, 2016. Of this amount, $651,753 represents the replacement value of the annuity in default as of June 30, 2018.

7. AUDIT ADJUSTMENTS

The unaudited financial statements presented in the annual reports of the Commissioner of Insurance to the Governor and the Legislature have been adjusted to reflect suggested audit adjustments.

8. PRIOR PERIOD ADJUSTMENT

There were two prior period adjustments necessary for the financial statements under review. A prior period adjustment for FY 2017-18 of ($71,751) and for FY 2016-17 of ($740,820). Both adjustments were related to retroactive adjustments of claimants' accounts.

9. SUBSEQUENT EVENT

Under s. 655.015, Wis. Stats., the Injured Patients and Families Compensation Fund is charged with "crediting each claimant's account with a proportionate share of any interest earned by the fund, based on that account's proportionate share of the fund." Previously, the interest rate credited to claimants' accounts had been based on the interest earnings of the State Investment Fund.

It was determined that the prevailing rate did not accurately apply the proportionate share of interest earned by the Fund, pursuant to ch. 655, Wis. Stats. The new rate of 3.5 percent applies earnings based on the Fund's fixed-income portfolio, as approved by the Board of Governors at its December 19, 2018 meeting. The adopted rate was retroactively applied as of October 31, 2018 to all Future Medical Expense accounts extending back for a period of ten years beginning in 2008. The actual amount of earnings credited to accounts was $11.9 million.

■ ■ ■ ■

Auditor’s Report ■

STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

Report 19-9

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Mr. Mark V. Afable, Commissioner
Office of the Commissioner of Insurance

We have audited the financial statements and the related notes of the Injured Patients and Families Compensation Fund as of and for the years ended June 30, 2018, June 30, 2017, and June 30, 2016, and have issued our report thereon dated May 29, 2019. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Injured Patients and Families Compensation Fund is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits of the financial statements, we considered the Injured Patients and Families Compensation Fund's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent misstatements, or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the Injured Patients and Families Compensation Fund financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control that we consider to be significant deficiencies. In the accompanying findings and responses schedule, we consider the deficiency described in Finding 1 to be a significant deficiency for the year ended June 30, 2016, and the deficiency described in Finding 2 to be a significant deficiency for the year ended June 30, 2018. In addition, Finding 3 in the accompanying findings and responses schedule reports a significant deficiency for the year ended June 30, 2016, that we identified with controls over the reconciliation of cash at the Department of Administration (DOA). We believe this deficiency should be reported to the users of the financial statements of the Injured Patients and Families Compensation Fund.

Because the Injured Patients and Families Compensation Fund's financial activity is also included in the State of Wisconsin's Comprehensive Annual Financial Report, these significant deficiencies are also included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters related to our audit of the State of Wisconsin's financial statements. We note that corrective actions have since been taken to address the significant deficiencies reported for FY 2015-16 as findings 1 and 3 in the accompanying findings and response schedule.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Injured Patients and Families Compensation Fund's financial statements are free from material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Wisconsin Injured Patients and Families Compensation Fund's Response to Findings

The Injured Patients and Families Compensation Fund's written response to the findings identified in our audit is included in the accompanying schedule of findings and responses. The Injured Patients and Families Compensation Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the Injured Patients and Families Compensation Fund's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Injured Patients and Families Compensation Fund's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

May 29, 2019

FINDINGS AND RESPONSES SCHEDULE

Finding 1: Financial Reporting Process (FY 2015-16)

Criteria:

The Injured Patients and Families Compensation Fund (IPFCF), which is administered by the Office of the Commissioner of Insurance, is responsible for maintaining effective internal controls to ensure the financial information is fairly presented and that misstatements are prevented, or detected and corrected in a timely manner. As a proprietary fund, IPFCF is responsible for preparing the Statement of Cash Flows. Generally accepted accounting principles require that, in general, the Statement of Cash Flows presents the amounts of cash receipts and disbursements at gross and that the amounts of cash receipts and disbursements are not netted together.

Condition:

Inaccurate information was used to prepare the Statement of Cash Flows. Although IPFCF staff indicated that they had identified discrepancies in the investment activity information and were working to resolve them, IPFCF did not properly report cash receipts and disbursements in the investing activities section of the Statement of Cash Flows.

Questioned Costs:

None.

Context:

IPFCF insures participating physicians and other health care providers in Wisconsin against medical malpractice claims that exceed the primary malpractice insurance thresholds established by statutes. IPFCF's investments are managed by the State of Wisconsin Investment Board (SWIB). IPFCF uses investment activity information it receives from SWIB for financial reporting purposes.

Effect:

Although there was no effect on the total of the Cash Flows from Investing Activities section of the Statement of Cash Flows, the amounts reported for Cash Received from Proceeds from Sales of Investments was understated by approximately $744 million, Cash Paid for Purchase of Investment Securities was understated by approximately $721 million, and Interest Received was understated by approximately $23 million. Staff subsequently adjusted IPFCF's Statement of Cash Flows to correct the error.

Cause:

IPFCF staff indicated that the investment activity information they received from SWIB did not provide the level of detail necessary to enable them to report the gross amounts of investing activities. IPFCF staff also indicated that SWIB did not provide the necessary information to enable them to properly account for a transfer of IPFCF's investments.

☑ **Recommendation**

We recommend the Injured Patients and Families Compensation Fund take steps to ensure that investment activity is properly reported in its Statement of Cash Flows.

Response and Corrective Action Plan from the Office of the Commissioner of Insurance: OCI's response and corrective action plan were included in report 17-4 but are not included here because OCI has taken action to address the recommendation.

Finding 2: Financial Reporting Process (FY 2017-18)

Criteria:

IPFCF, which is administered by the Office of the Commissioner of Insurance, insures participating physicians and other health care providers in Wisconsin against medical malpractice claims that exceed the primary insurance thresholds established by statutes. IPFCF is a proprietary fund, and IPFCF staff are responsible for preparing and submitting financial statements and required supplementary information. IPFCF is responsible for maintaining effective internal controls to ensure the financial information is fairly presented and that misstatements are prevented, or detected and corrected in a timely manner.

Condition:

IPFCF's process for preparing and reviewing financial information was not sufficient to prevent, or detect and correct in a timely manner certain substantive misstatements.

Questioned Costs:

None.

Context:

We reviewed the FY 2017-18 financial statements and required supplementary information, discussed the process used in compiling the information with IPFCF staff, and examined supporting documentation.

Effect:

Through our review, we identified various misstatements, including the following:

- Current Investments was understated and Noncurrent Investments was overstated by $16.9 million on the Statement of Net Position.

- Net Change in Unrealized Gains (Losses) on the Statement of Cash Flows was overstated by $9.7 million.

- The related notes to the financial statements did not include disclosures required under GASB Statement Number 72, *Fair Value Measurement and Application*.

IPFCF staff corrected the misstatements we identified.

Cause:

IPFCF's procedures for reviewing the financial statements and required supplementary information were not sufficient to prevent, or detect and correct in a timely manner certain substantive misstatements. Although IPFCF staff indicated that they used checklists in preparing and reviewing this information, these resources did not include all steps needed to prevent the misstatements that we identified.

☑ **Recommendation**

We recommend the Wisconsin Office of the Commissioner of Insurance, Injured Patients and Families Compensation Fund, improve its process for preparing and reviewing the financial statements and required supplementary information, such as by identifying and specifying further analyses to assess reasonableness, as well as incorporating additional reviews to identify readily apparent misstatements.

Response and Corrective Action Plan from the Wisconsin Office of the Commissioner of Insurance: The Office of the Commissioner of Insurance recognizes, and agrees, with the interim findings. IPFCF has identified three avenues through which the Fund can improve its review process:

- Independent internal review by qualified OCI staff
- External review by a vendor
- Combination of independent internal review and external review

OCI has identified four individuals within the Funds and Program Management area who are qualified to review financial statements and supplementary information. These individuals are not involved in any aspect of the financial management of IPFCF, thus have no access to the Fund's information unless it is provided, assuring an independent review.

OCI has also identified an outside accounting firm who specialized in insurance accounting, and is familiar with the State's CAFR. Their services would have to be secured through the Request for Bid process with the Department of Administration (DOA).

OCI will determine which of the three options best compliments the skills of a new Accountant, and is feasible with current internal workloads. Fund management anticipates that external assistance will be needed at some level and will pro-actively state the Request for Bid process with DOA. The procurement process is not completely within the Fund's control, however we anticipate the Request for Bid will be posted in the near future.

Finding 3: Cash Reconciliations at the Department of Administration (FY 2015-16)

DOA is responsible for performing certain centralized internal control functions related to cash. State agencies, including OCI, rely on these controls. As part of our separate audit of DOA, we identified a significant deficiency in the centralized controls related to cash. This weakness relates to the lack of complete and timely reconciliations of cash reported by the bank with cash balances reported in the State's central accounting system. This control is important to ensure cash balances are accurate and to ensure all receipts and disbursements have been properly recorded. Due to the pervasiveness of the deficiency and its effects on state agencies and programs, this deficiency is reported to the users of the financial statements of IPFCF. We communicated this weakness to DOA, who agreed with the finding. DOA's response was included in our separate report related to the State's FY 2015-16 Comprehensive Annual Financial Report (report 17-4). We did not request a response from the management of IPFCF since DOA was responsible for corrective action. DOA has since taken corrective action to address the significant deficiency.

■ ■ ■ ■

Response ■

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Injured Patients and Families Compensation Fund

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-6830 • Fax: (608) 226-5536
ociipfcf@wisconsin.gov
oci.wi.gov

Tony Evers, *Governor*
Mark V. Afable, *Commissioner*

Wisconsin.gov

June 3, 2019

Joe Chrisman
State Auditor
Legislative Audit Bureau
22 E Mifflin St, Ste 500
Madison, WI 53703

Re: IPFCF Audit FY '16, FY '17, FY '18

Dear Mr. Chrisman,

The Injured Patients and Families Compensation Fund appreciates the opportunity to respond to the recommendations provided in the IPFCF's Audit Report for the years ending on June 30, 2016, June 30, 2017, and June 30, 2018. The Fund would like to address the following recommendations:

We recommend the Office of the Commissioner of Insurance work with the Board of Governors:

- ***Develop a formal written plan for re-evaluating the target range for the Fund's net position, including the anticipated steps needed to complete the re-evaluation;***
- ***Specify an estimated completion date for each step;***
- ***Provide update on the progress of the re-evaluation as part of the Annual Functional Progress Report required by s. 655.27 (4) (f), Wis. Stats., including the results and determinations upon completion of the re-evaluation;***
- ***Provide a copy of the Annual Functional and Progress Report to the Joint Legislative Audit Committee.***

There was a joint meeting of the Fund's Finance & Audit Committee and the Actuarial & Underwriting Committee on May 21st, 2019 during which the Committees started to draft the re-evaluation plan and timeline for satisfying this requirement. The Fund will amend its Annual Functional Progress Report to include an update, or a finalized plan, as appropriate.

We recommend the Wisconsin Office of the Commissioner of Insurance, Injured Patient and Families Compensation Fund, improve its process for preparing and reviewing the financial statements and required supplementary information, such as by identifying and specifying further analysis to asses reasonableness, as well as incorporating additional reviews to identify readily apparent misstatements.

As reflected in the Audit Report, the Fund submitted a comprehensive Corrective Action Plan to the Legislative Audit Bureau to address this recommendation. The Fund continues to work with the Department of Administration, through the Request for Bid process, to secure an independent accounting firm qualified to provide assistance with the filing of the annual CAFR reports, amongst other audit and accounting related tasks. The Fund has initiated some targeted internal audits and is re-evaluating its internal reporting mechanisms. IPFCF is also preparing a Request for Proposal for a new fund management system, specifically focusing on providing enhanced financial reporting and Business Intelligence analysis.

The Fund fully supports the recommendations made in the audit report and will work diligently to implement them in a timely fashion.

In closing, the Office of the Commissioner of Insurance, and the Injured Patients and Families Compensation Fund, wish to express their appreciation to the Legislative Audit Bureau staff for their constructive, cooperative, and comprehensive approach to the audit process.

Thank you again for the opportunity to respond to the recommendations resulting from this audit. Please feel free to contact me should you have any additional questions or concerns.

Sincerely,

Mark V Afable

Mark V. Afable
Commissioner of Insurance

Cc: Kate Ludlum
Brynn Bruijn-Hansen