Financial Statements - Modified Cash Basis
and Other Financial Information

# Florida Workers' Compensation Insurance Guaranty Association, Inc.

*Years ended December 31, 2017 and 2016*
*with Report of Independent Auditors*

Thomas Howell Ferguson P.A.
*Certified Public Accountants*

Florida Workers' Compensation Insurance Guaranty Association, Inc.

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## Contents

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# Report of Independent Auditors

The Board of Directors
Florida Workers' Compensation Insurance Guaranty Association, Inc.

## Report on the Financial Statements

We have audited the accompanying financial statements of Florida Workers' Compensation Insurance Guaranty Association, Inc. (the Association) which comprise the statements of financial position - modified cash basis as of December 31, 2017 and 2016, the related statements of activities and changes in net assets - modified cash basis for the years then ended, and the related notes to the financial statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified basis of cash receipts and disbursements described in Note 1; this includes determining that the modified basis of cash receipts and disbursements is an acceptable basis of accounting for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 Association'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 Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of the Florida Workers' Compensation Insurance Guaranty Association, Inc. as of December 31, 2017 and 2016, and its revenue collected and expenses paid during the years then ended in accordance with the modified basis of cash receipts and disbursements described in Note 1.

**Basis of Accounting**

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified basis of cash receipts and disbursements, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

**Other Matter**

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of general and administrative expenses is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Thomas Howell Ferguson P.A.

Tallahassee, Florida
April 24, 2018

# Florida Workers' Compensation Insurance Guaranty Association, Inc.

## Statements of Financial Position - Modified Cash Basis

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **Assets** | | |
| Cash and short-term investments: | | |
| Cash and cash equivalents | **$ 6,021,875** | $ 9,302,662 |
| Short-term investments | **14,924,348** | 1,612,204 |
| Total cash and short-term investments | **20,946,223** | 10,914,866 |
| Accrued interest income | **433,539** | 469,007 |
| Investments | **74,345,806** | 94,198,797 |
| Property and equipment, net | **969,925** | 998,488 |
| Total assets | **$ 96,695,493** | $ 106,581,158 |
| **Liabilities and net assets** | | |
| Liabilities | **$ -** | $ - |
| Temporarily restricted net assets | **96,695,493** | 106,581,158 |
| Total liabilities and net assets | **$ 96,695,493** | $ 106,581,158 |

*See accompanying notes.*

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Statements of Activities and Changes in Net Assets -
Modified Cash Basis

| | Years ended December 31, 2017 | 2016 |
|---|---|---|
| Revenues: | | |
| Investment income, net of related expenses | **$ 1,504,761** | $ 1,558,705 |
| Estate distributions and claim recoveries | **13,625,170** | 15,041,490 |
| Other income | **3,517** | 1,847,786 |
| Total revenues | **15,133,448** | 18,447,981 |
| Expenses: | | |
| Claims and claims adjustment expenses paid | **23,513,330** | 22,958,588 |
| Direct estate expenses | **69,314** | 91,105 |
| General and administrative expenses | **1,436,469** | 1,380,418 |
| Total expenses | **25,019,113** | 24,430,111 |
| Change in net assets | **(9,885,665)** | (5,982,130) |
| Temporarily restricted net assets at beginning of year | **106,581,158** | 112,563,288 |
| Temporarily restricted net assets at end of year | **$ 96,695,493** | $ 106,581,158 |

*See accompanying notes.*

## 1. Organization and Significant Accounting Policies

The Florida Workers' Compensation Insurance Guaranty Association, Inc. (the Association), a not-for-profit corporation, was established pursuant to Chapter 631 of the Florida Statutes. The Association was created to provide a mechanism for the payment of covered workers' compensation claims of insolvent insurers and to assist in the detection and prevention of insurer insolvencies. The Association operates under the supervision and approval of a board of directors, which is comprised of eleven persons, one is the consumer advocate appointed pursuant to Chapter 627.0613, Florida Statutes, one appointed by the Chief Financial Officer of the state of Florida, one appointed by the Governor of the State of Florida, and eight selected by insurance company and self-insurance fund members, and subsequently appointed by the Florida Department of Financial Services.

The Association is managed by the American Guaranty Fund Group (AGFG) through a management and administrative services agreement (see Note 5). AGFG also has an agreement with the Florida Insurance Guaranty Association (FIGA), a related party through common management, for these services. The Association and FIGA are equal members of AGFG, but control is maintained by the members through equal representation on the board of directors.

The members of the Association are all insurers that provide workers' compensation coverages in the state of Florida.

The funding of the Association's activities is provided by distributions from the estates of insolvent insurers and assessments of members. The assessments are levied on insurers writing workers' compensation coverages in the state of Florida and are levied based on a percentage of net direct written premiums for workers' compensation coverages collected during the period specified in the levy. The maximum assessment rate is 2% for insurance companies and self-insurance funds. If assessments are insufficient to satisfy claims and administration costs, then an additional assessment of 1.5% may be levied. There were no assessments levied for 2017 and 2016.

The accounting policies and methods of their application that significantly affect the assets and liabilities arising from cash transactions and changes in the modified cash basis net assets of the Association are as follows:

**1. Organization and Significant Accounting Policies (continued)**

**Basis of Accounting**

The financial statements of the Association are prepared on a modified basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP). This basis of presentation differs from GAAP in that certain revenues are recognized when received rather than earned and certain expenses are recognized when paid rather than when the obligation is incurred. Specifically, the variances from GAAP include omission of assessments receivable and accruals for loss and loss adjustment expense reserves of insolvent insurance companies and self-insurance funds assumed by the Association. Such variances are presumed to be material. However, similar to financial statements prepared in accordance with GAAP, these financial statements reflect the capitalized cost of property and equipment and related depreciation, accrued interest income and amounts held by the Association for others in a fiduciary capacity. The accompanying financial statements are not intended to present the financial position and results of operations in conformity with accounting principles generally accepted in the United States of America.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of deposits with financial institutions and deposits in highly liquid money market funds with original maturities of three months or less. Deposits with financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 per depositor. Bank deposits at times may exceed federally insured limits. The Association has not experienced any losses in such accounts.

**Investments**

Investments are reported at amortized cost. Short-term investments include securities with original maturity dates of one year or less.

**Concentration of Credit Risk**

The Association's financial instruments exposed to concentrations of credit risk consist primarily of its cash, cash equivalents, short-term investments, investments, and assessment revenue.

All investment transactions have credit exposure to the extent that a counterparty may default on an obligation to the Association. Credit risk is a consequence of carrying investment positions. To manage credit risk, the Association focuses primarily on higher quality, fixed income securities, reviews the credit strength of all entities in which it invests, limits its exposure in any one investment, and monitors portfolio quality, taking into account credit ratings assigned by recognized credit rating organizations.

## 1. Organization and Significant Accounting Policies (continued)

### Property and Equipment

Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets that range from three to 39 years. The Association's policy is to capitalize asset acquisitions greater than $1,000.

### Net Assets

The Association's modified cash basis net assets are temporarily restricted and represent funds held from assessments, distributions from the estates of insolvent insurers and other sources to pay covered workers' compensation claims of insolvent insurers and administrative costs as they come due.

### Income Taxes

The Association is exempt from federal income taxes under Section 501 of the Internal Revenue Code as a 501(c)(6) organization. The Association elects to pay the proxy tax on lobbying expenditures instead of reporting a portion of member dues as non-deductible. Income tax expense was $7,875 and $6,125, respectively, for the years ending December 31, 2017 and 2016. With few exceptions, the Association is no longer subject to examinations by major tax jurisdictions for years ended December 31, 2013 and prior.

### Assessments

Assessments are recorded at the time they are received by the Association.

### Estate Distributions and Claim Recoveries

Amounts received by the Association for estate distributions and claim recoveries are recognized in the period received. Estate distributions and claim recoveries include reinsurance recoveries by the receivers, direct claim recoveries, and any other distribution of estate assets.

### Claims and Claims Adjustment Expenses Paid

Claims and claims adjustment expenses paid consist of amounts paid on claims of insolvent insurers.

### Direct Estate Expenses

Direct estate expenses are expenses incurred by the Association related directly to the protection of the Association's interest in the administration of specific insolvent insurers' estates.

## 1. Organization and Significant Accounting Policies (continued)

### General and Administrative Expenses

The Association records general and administrative expenses when paid.

### Use of Estimates

The preparation of financial statements in conformity with the modified basis of cash receipts and disbursements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

### Subsequent Events

The Association has evaluated subsequent events through April 24, 2018, the date the financial statements were available to be issued. During the period from December 31, 2017 to April 24, 2018, the Association did not have any material recognizable subsequent events other than the matter disclosed in Note 9.

## 2. Investments

The Association invests in government and corporate bonds, commercial paper, and other fixed maturity obligations. The fair values of investments are estimated based on their quoted market values for the specific investments. The amortized cost and fair value of these investments are as follows:

| | December 31, 2017 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| U.S. Treasury notes | $ 24,225,663 | $ 23,994,257 |
| U.S. Government agency obligations | 5,982,342 | 5,917,770 |
| Mortgage-backed and collateralized mortgage obligations | 7,511,300 | 7,426,214 |
| Asset-backed securities | 7,396,020 | 7,366,292 |
| Corporate bonds | 35,797,412 | 35,634,292 |
| Municipal obligations | 5,210,025 | 5,185,668 |
| Commercial paper | 499,619 | 499,857 |
| Supranational agencies | 2,647,773 | 2,605,106 |
| | 89,270,154 | 88,629,456 |
| Less short-term investments | 14,924,348 | 14,907,719 |
| Investments | $ 74,345,806 | $ 73,721,737 |

## 2. Investments (continued)

| | December 31, 2016 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| U.S. Treasury notes | $ 30,022,553 | $ 29,973,978 |
| U.S. Government agency obligations | 6,761,772 | 6,729,194 |
| Mortgage-backed and collateralized mortgage obligations | 4,683,602 | 4,636,961 |
| Asset-backed securities | 6,879,124 | 6,867,508 |
| Corporate bonds | 41,757,688 | 41,631,530 |
| Municipal obligations | 5,207,053 | 5,200,229 |
| Commercial paper | 499,209 | 502,679 |
| | 95,811,001 | 95,542,079 |
| Less short-term investments | 1,612,204 | 1,613,589 |
| Investments | $ 94,198,797 | $ 93,928,490 |

A summary of the amortized cost and fair value of the Association's bonds and other investments at December 31, 2017, by maturity is as follows:

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 14,924,348 | $ 14,907,719 |
| Due after one year through five years | 74,345,806 | 73,721,737 |
| Due after five years through ten years | - | - |
| Due after ten years | - | - |
| Total | $ 89,270,154 | $ 88,629,456 |

The foregoing data is based on the expected maturities for bonds. These expected maturities might differ from the contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Investment income consists of interest income and net realized gains (losses) and is reported net of investment management expenses of $73,031 and $75,084 for the years ended December 31, 2017 and 2016, respectively. Net realized gains for the years ended December 31, 2017 and 2016 were $34,241 and $53,327, respectively.

## 3. Fair Value Measurements

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. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

**3. Fair Value Measurements (continued)**

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
Level 3: Unobservable inputs that are not corroborated by market data.

The Association utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

The tables below present the balances of assets measured at fair value on a recurring basis.

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | **Total** | **Level 1** | **Level 2** | **Level 3** |
| U.S. Government and government agency bonds | **$ 29,912,027** | **$ -** | **$ 29,912,027** | **$ -** |
| Mortgage-backed and collateralized mortgage obligations | **7,426,214** | **-** | **7,426,214** | **-** |
| Asset-backed securities | **7,366,292** | **-** | **7,366,292** | **-** |
| Corporate bonds | **35,634,292** | **-** | **35,634,292** | **-** |
| Municipal obligations | **5,185,668** | **-** | **5,185,668** | **-** |
| Commercial paper | **499,857** | **-** | **499,857** | **-** |
| Supranational agencies | **2,605,106** | **-** | **2,605,106** | **-** |
| | **$ 88,629,456** | **$ -** | **$ 88,629,456** | **$ -** |

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | **Total** | **Level 1** | **Level 2** | **Level 3** |
| U.S. Government and government agency bonds | $ 36,703,172 | $ - | $ 36,703,172 | $ - |
| Mortgage-backed and collateralized mortgage obligations | 4,636,961 | - | 4,636,961 | - |
| Asset-backed securities | 6,867,508 | - | 6,867,508 | - |
| Corporate bonds | 41,631,530 | - | 41,631,530 | - |
| Municipal obligations | 5,200,229 | - | 5,200,229 | - |
| Commercial paper | 502,679 | - | 502,679 | - |
| | $ 95,542,079 | $ - | $ 95,542,079 | $ - |

Fair values of the Association's debt securities (bonds) reported in Level 2 are based on average bid prices of identical or similar issues with the same life and expected yields. There have been no changes in the methodologies used at December 31, 2017 and 2016.

## 4. Property and Equipment

Property and equipment consists of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Land | **$ 310,000** | $ 310,000 |
| Building | **883,463** | 883,463 |
| Office furniture and equipment | **25,749** | 25,749 |
| Computer equipment and software | **184,142** | 183,509 |
| Leasehold improvements | **88,138** | 86,826 |
| | **1,491,492** | 1,489,547 |
| Less accumulated depreciation | **521,567** | 491,059 |
| | **$ 969,925** | $ 998,488 |

Depreciation and amortization expense totaled $30,508 and $34,476 for the years ended December 31, 2017 and 2016, respectively.

The Association and FIGA are the owners of real property together with certain tangible property. The Association owns an undivided 50% interest in the property which is reported above as land and building.

## 5. Administrative and Service Company Agreements

The Association and FIGA have entered into agreements with AGFG to provide management and administrative services. Under the terms of the Association's agreement, AGFG provides management and administrative services, including but not limited to general management responsibility, finance and accounting, overseeing and managing the Association's claims division, managing and supervising the day to day activities of the Association, and other management or administrative services. The Association and FIGA reimburse AGFG for all amounts paid by AGFG. Costs incurred by AGFG that are directly attributable to a specific entity are charged to the applicable entity. All other costs incurred by AGFG are distributed equitably to the Association and FIGA based on various allocation methods. The Association's contract may be terminated with 30 days written notice by either party, with or without cause. The Association and FIGA each pay AGFG in advance of each calendar year an amount equal to the two month average budget for that entity projected for the upcoming calendar year. The operating advance paid to AGFG was $128,839 and $140,984 at December 31, 2017 and 2016, respectively.

Amounts paid to AGFG under this agreement totaled $1,747,005 and $1,908,271 for the years ended December 31, 2017 and 2016, respectively, and are reported in general and administrative expenses, claims and claims adjustment expenses, and direct estate expenses.

## 6. Commitments

As more fully described in Note 1, the Association has assumed the outstanding claims and claims adjustment expense liabilities of insolvent workers' compensation insurers in the state of Florida. The case-basis claims and claims adjustment expense reserves for known insolvent insurers at December 31, 2017 and 2016, are approximately $213,000,000 and $140,000,000, respectively (see Note 9 below). An actuarial determination of the ultimate value of the outstanding claim liabilities has not been made.

The Association and its predecessors have received early access distributions from the receivers of insolvent insurers. Some of these distributions were received pursuant to agreements that provide that in the event the distributions exceed the Association's final pro rata distribution from the insolvencies, the Association will return any excess to the receiver.

During the ordinary course of business, the Association is involved in various litigation. The ultimate outcome of such litigation is uncertain. However, management and legal counsel are of the opinion that any resulting unfavorable outcomes would have minimal adverse economic impact on the Association.

## 7. Retirement Plan

The Association employees have the option of participating in the AGFG 401(k) Profit Sharing Plan (the Plan). The Plan is available to employees meeting certain entry requirements. The Association makes discretionary employer contributions to the Plan on a matching basis. Employer contributions paid for the years ended December 31, 2017 and 2016, were $68,290 and $67,339, respectively.

## 8. Net Assets

The Association classifies all net assets as temporarily restricted. Net assets are considered restricted by Florida Statutes until expended for Association operations and payment of claims.

## 9. Subsequent Event

Subsequent to year end, the Association received additional information on the case-basis claims and claims adjustment expense reserves of an insolvent insurer that had been placed in liquidation in November 2017. Based on an analysis of this information, the case-basis claims and claims adjustment expenses for known insolvent insurers has increased from approximately $213,000,000 to approximately $304,000,000 as of March 31, 2018.

# Other Financial Information

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Schedule of General and Administrative Expenses

| | Years ended December 31, 2017 | 2016 |
| --- | --- | --- |
| Accounting and auditing | **$ 56,561** | $ 63,680 |
| Bank fees | **28,202** | 25,696 |
| Consulting | **6,193** | 6,107 |
| Depreciation | **30,508** | 34,476 |
| Dues and publications | **55,528** | 52,856 |
| Furniture and equipment | **38,234** | 42,222 |
| Insurance | **53,158** | 51,223 |
| Legal fees | **52,840** | 47,754 |
| Office supplies and printing | **2,077** | 2,555 |
| Change in operating advance and prepaid expenses | **46,109** | (942) |
| Postage and shipping | **1,815** | 2,565 |
| Premises | **24,398** | 25,113 |
| Salaries and benefits | **973,483** | 963,171 |
| Taxes and licenses | **20,567** | 19,035 |
| Telephone | **9,175** | 9,112 |
| Travel and meals | **37,621** | 35,795 |
| | **$ 1,436,469** | $ 1,380,418 |

*See report of independent auditors.*