



JASON E. MUMPOWER  
*Comptroller*

## Independent Auditor's Report

Members of the General Assembly  
Members of the Board of Claims  
The Honorable David H. Lillard, Jr., Treasurer

### Report on the Audit of the Financial Statements

#### *Opinion*

We have audited the accompanying statement of net position of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2023; the related statements of revenues, expenses, and changes in fund net position, and cash flows for the year then ended; and the related notes to the financial statements, which collectively comprise the Risk Management Fund's basic financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Risk Management Fund as of June 30, 2023, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### *Basis of Opinion*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Risk Management Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the Board of Claims. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Risk Management Fund.

## *Responsibilities of Management for the Financial Statements*

Management 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Risk Management Fund's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

## *Auditor's Responsibility for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit 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 Risk Management Fund's internal control. Accordingly, no such opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Risk Management Fund's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

### *Emphasis of Matter*

As discussed in Note A.1, the financial statements present only the Risk Management Fund, an internal service fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2023, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2023, on our consideration of the Risk Management Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Risk Management Fund's internal control over financial reporting and compliance.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 12, 2023

# Risk Management Fund

## Risk Management Fund Statement of Net Position June 30, 2023

### ASSETS

#### Current Assets

Cash and Cash Equivalents	\$	254,368,010
Accounts Receivable		442,842
Total Current Assets		<u>254,810,852</u>

#### Noncurrent Assets

Machinery & Equipment		70,196
Less: Accumulated Depreciation		(585)
Total Noncurrent Assets		<u>69,611</u>

### TOTAL ASSETS

254,880,463

### LIABILITIES

#### Current Liabilities

Accounts Payable		1,216,224
Unearned Revenue		1,000
Claims Liability		135,776,514
Total Current Liabilities		<u>136,993,738</u>

#### Noncurrent Liabilities

Claims Liability		<u>80,390,980</u>
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### TOTAL LIABILITIES

217,384,718

### NET POSITION

Investment in Capital Assets		69,611
Unrestricted		37,426,134
Total Net Position	\$	<u>37,495,745</u>

*See accompanying Notes to the Financial Statements*

# Risk Management Fund

## Risk Management Fund Statement of Revenues, Expenses, and Changes in Net Position For the Year Ended June 30, 2023

OPERATING REVENUES	
Casualty Premiums	\$ 9,653,970
Property Premiums	7,096,830
Return to Work Penalties	61,999
Tort Auto Liability/LAG Penalties	59,000
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TOTAL OPERATING REVENUES	16,871,799
OPERATING EXPENSES	
Claim Payments	
Torts	4,472,230
Workers' Compensation	16,159,303
Property Damage	5,108,880
Total Claim Payments	25,740,413
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Property Insurance Premiums	33,669,123
Professional/Administrative	12,260,885
Net Change in Accrued Liability	(9,125,467)
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TOTAL OPERATING EXPENSES	62,544,954
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OPERATING INCOME (LOSS)	(45,673,155)
NON-OPERATING REVENUES	
Interest Income	8,710,921
Taxes	800
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TOTAL NON-OPERATING REVENUES	8,711,721
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CHANGE IN NET POSITION	(36,961,434)
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NET POSITION, BEGINNING OF YEAR	74,457,179
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NET POSITION, END OF YEAR	\$ 37,495,745
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See accompanying Notes to the Financial Statements

# Risk Management Fund

## Risk Management Fund Statement of Cash Flows For the Year Ended June 30, 2023

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from Premiums	\$ 16,837,950
Receipts for Insurance Proceeds	62,096,705
Payments for Claims	(31,973,394)
Payments for Administrative Expenses	(12,250,487)
Payments for Insurance Premiums	(33,728,311)
NET CASH FROM OPERATING ACTIVITIES	<u>982,463</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Taxes Received	800
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	<u>800</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest Received	8,710,921
NET CASH AND CASH EQUIVALENTS FROM INVESTING ACTIVITIES	<u>8,710,921</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	9,694,184
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>244,673,826</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 254,368,010</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH FROM OPERATING ACTIVITIES	
OPERATING LOSS	\$ (45,673,155)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH FROM OPERATING ACTIVITIES	
Depreciation	585
CHANGES IN ASSETS AND LIABILITIES	
Increase in Accounts Receivable	(123,914)
Decrease in Accounts Payable	348,724
Decrease in Claims Liability	46,430,223
TOTAL ADJUSTMENTS	<u>46,655,618</u>
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 982,463</u>

See accompanying Notes to the Financial Statements

Risk Management Fund  
Notes to the Financial Statements  
June 30, 2023

## **A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **1. Reporting Entity**

The Risk Management Fund (RMF) is part of the primary government and has been included in the *Tennessee Annual Comprehensive Financial Report* as an internal service fund. That report is available on the state's website at <https://www.tn.gov/finance/rd-doa/fa-accfn-ar.html>.

### **2. Measurement Focus and Basis of Accounting**

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. The RMF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the services provided by the RMF. The principal operating revenue of the RMF consists of charges to its customers for insurance premiums. Operating expenses include claims expenses, insurance premiums, administrative expenses and the current charge to the accrued liability. Revenues and expenses not resulting from the services provided by the RMF are reported as nonoperating revenues and expenses.

### **3. Cash and Cash Equivalents**

The Risk Management Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally recognized ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented in the State Pooled Investment Fund Report. That report is available on the state's website at <https://treasury.tn.gov>.

## **B: OTHER ACCOUNTING DISCLOSURES**

### **1. Risk Management**

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, medical malpractice liability, and workers' compensation. By statute, the maximum liability for general liability, automobile liability, and medical malpractice liability is \$300,000 per person and \$1 million per occurrence. The state's management believes it is more economical to manage

# Risk Management Fund

these risks internally and set aside assets for claim settlement in its internal service fund, the RMF. The state self-insures against property and cyber liability losses through the RMF and the State of Tennessee Captive Insurance Company (TCIC). The state purchases commercial insurance for real property, crime, and fidelity coverage on the state's officials and employees above the limits of the RMF and TCIC. For property coverage, the deductible for an individual state agency is the first \$25,000 to \$75,000 of losses based on a tiered deductible system that accounts for averaged losses over a three year period, and the type of loss. The RMF is responsible for property losses of \$2.5 million per occurrence for all perils. The TCIC is responsible for property losses in excess of the RMF limits up to an annual aggregate of \$25 million. Purchased insurance coverage is responsible for losses exceeding these limits to the maximum insurance coverage of \$600 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in the New Madrid Zone. For cyber coverage, the RMF is responsible for \$1.5 million per occurrence. The TCIC is responsible for losses in excess of the RMF limits up to an aggregate of \$10 million. Settled claims resulting from these risks have not exceeded maximum commercial insurance coverage in any of the past three fiscal years. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Committee and the Certified Cotton Growers' Organization. The Tennessee Education Lottery Corporation participates in the RMF for general liability purposes but is responsible for its own worker's compensation coverage.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

The present value of the casualty liability as actuarially determined was \$92,415,000 (discounted at 4.0%) at June 30, 2023. The accrued liability for incurred property losses was \$23,695,686 at June 30, 2023. The changes in the balances of the claims liabilities during fiscal year 2023 were as follows:

<b>Beginning Claims Liability</b>	<b>Current Year Claims and Changes in Estimates</b>	<b>Claims Payments</b>	<b>Ending Claims Liability</b>
\$169,737,270	78,711,651	(32,281,427)	\$216,167,494

The RMF held \$254 million in cash at June 30, 2023 that is designated for payment of these claims.

The RMF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole.



## 2. Receivable

The receivables shown on the Statement of Net Position include \$318,993 due from the federal government for Medicare offsets, \$33,849 due from component units of the state for RMF penalties, and \$90,000 due from the State's insurance broker for reimbursement of captive management fees paid by the RMF.

## 3. Insurance Proceeds

The State receives property insurance proceeds from our commercial insurance carriers in excess of our deductible and the \$25 million aggregate covered by the State of Tennessee Captive Insurance Company (TCIC) for losses. Current estimated property losses at June 30, 2023 were \$187,196,466 while estimated proceeds from commercial insurance carriers above our deductibles for claim years prior to fiscal year 2023 were \$142,003,218. Additionally, estimated proceeds from TCIC above deductibles for fiscal year 2023 were \$21,497,562. This results in a \$23,695,686 liability for property losses to be established at June 30, 2023. Additionally there is a balance at June 30, 2023 of \$100,056,808 of insurance proceeds on hand for the payment of claims.

## 4. Net Position – Investment in Capital Assets

Investment in capital assets consists of capital assets, net of accumulated depreciation. These capital assets include computer vision detection equipment installed on two state vehicles for the initial purpose of detecting potholes on state-maintained roadways.

## 5. Related Party Transactions

During fiscal year 2023, the Risk Management Fund (RMF) purchased property and cyber insurance policies from the State of Tennessee Captive Insurance Company (TCIC). The purpose of the TCIC is to provide insurance coverage solely to the State of Tennessee and its component units, including but not limited to state institutions of higher education. See Note B.1 for deductibles and limits. The RMF paid TCIC \$13,287,100 for property coverage and \$1,594,100 for cyber coverage. These amounts are included in Property insurance premiums on the Statement of Revenues, Expenses, and Changes in Fund Net Position. Additionally, the claims liability for RMF was reduced by estimated proceeds from the TCIC of \$21,497,562.