

FINANCIAL AUDIT
OF THE
STATE SPONSORED GROUP INSURANCE FUND

OFFICE OF THE STATE EMPLOYER AND
DEPARTMENT OF MANAGEMENT AND BUDGET

October 1, 1995 through September 30, 1997

EXECUTIVE DIGEST

STATE SPONSORED GROUP INSURANCE FUND

INTRODUCTION

This report contains the results of our financial audit* of the State Sponsored Group Insurance Fund (SSGIF), Office of the State Employer (OSE) and Department of Management and Budget (DMB), for the period October 1, 1995 through September 30, 1997.

AUDIT PURPOSE

This financial audit of the Fund was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

SSGIF was administratively established in fiscal year 1981-82 to account for employee and retiree insurance benefit program costs. The Group Insurance Section, Employee Benefits Division, Department of Civil Service, administered SSGIF until July 29, 1996, when the director of DMB assumed responsibility per Executive Order 1996-5. The director of DMB has assigned to OSE the responsibility for the administration of SSGIF and all insurance benefits for State employees.

Five group insurance programs are currently offered to State employees: dental, vision, life, long-term disability (LTD), and health. Funding for the various insurance

* See glossary on page 29 for definition.

programs is based on the respective pay action determinations made by the Civil Service Commission and varies among employee groups. Retirees of the State of Michigan are offered dental, vision, life, and health group insurance programs.

For fiscal year 1996-97, DMB reported total expenses and operating transfers for SSGIF of \$584.6 million. As of September 30, 1997, the Employee Benefits Division of OSE and DMB had 12 employees.

**AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS**

Audit Objective: To assess the adequacy of SSGIF's internal control structure*.

Conclusion: Our assessment of SSGIF's internal control structure did not disclose any material weaknesses*. However, we noted reportable conditions* related to fund equity and report monitoring (Findings 1 and 2).

Also, our assessment indicated that DMB was in substantial compliance with the requirements set forth in Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws* pertaining to its systems of internal accounting and administrative control.

Noteworthy Accomplishments: In the period since OSE and DMB assumed program responsibility for SSGIF, a comprehensive accounting record was established for each of the five group insurance programs. This accounting record will facilitate the development of premium rates that reliably reflect the cost of benefits provided.

* See glossary on page 29 for definition.

Audit Objective: To assess SSGIF's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and DMB policies and procedures that could have a material effect on the financial statements.

Conclusion: Our assessment of SSGIF's compliance with applicable statutes, regulations, policies, and procedures did not disclose any instances of noncompliance that could have a material effect on the financial statements. We have no findings to report for this objective.

Audit Objective: To audit SSGIF's financial statements as of and for the fiscal years ended September 30, 1997 and September 30, 1996.

Conclusion: We expressed an unqualified opinion on SSGIF's financial statements for the fiscal years ended September 30, 1997 and September 30, 1996. We have no findings to report for this objective.

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the State Sponsored Group Insurance Fund for the period October 1, 1995 through September 30, 1997. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit objective for the assessment of the internal control structure included an evaluation of DMB's implementation of the requirements for establishing and maintaining systems of internal accounting and administrative control, as set forth in Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws*.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our report includes 2 findings and 2 corresponding recommendations. OSE's and DMB's preliminary response indicated that they agree and will comply with our recommendations.

OSE and DMB had complied with all 4 of the prior audit recommendations.

Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

and

Ms. Janine M. Winters, Director
Office of the State Employer
Knapps Centre
Lansing, Michigan

Dear Ms. Phipps and Ms. Winters:

This is our report on the financial audit of the State Sponsored Group Insurance Fund, Office of the State Employer and Department of Management and Budget, for the period October 1, 1995 through September 30, 1997.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and independent auditor's reports on the internal control structure, on compliance with laws and regulations, and on the financial statements. This report also contains the State Sponsored Group Insurance Fund financial statements and notes to financial statements and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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TABLE OF CONTENTS

STATE SPONSORED GROUP INSURANCE FUND OFFICE OF THE STATE EMPLOYER AND DEPARTMENT OF MANAGEMENT AND BUDGET

INTRODUCTION

	<u>Page</u>
Executive Digest	1
Report Letter	5
Description of Agency	9
Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up	10

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

Internal Control Structure	12
1. Fund Equity	12
2. Report Monitoring	14
Compliance With Laws and Regulations	15
Financial Accounting and Reporting	15

INDEPENDENT AUDITOR'S REPORTS AND FINANCIAL STATEMENTS

Independent Auditor's Report on the Internal Control Structure	16
Independent Auditor's Report on Compliance With Laws and Regulations	18
Independent Auditor's Report on the Financial Statements	20
State Sponsored Group Insurance Fund Financial Statements	
Balance Sheet	22
Statement of Revenues, Expenses, and Changes in Retained Earnings	23
Statement of Cash Flows	24
Notes to Financial Statements	25

GLOSSARY

Glossary of Acronyms and Terms

29

Description of Agency

The State Sponsored Group Insurance Fund (SSGIF), Office of the State Employer (OSE) and Department of Management and Budget (DMB), was administratively established in fiscal year 1981-82 to account for employee and retiree insurance benefit program costs. The Group Insurance Section, Employee Benefits Division, Department of Civil Service, administered SSGIF until July 29, 1996, when the DMB director assumed responsibility per Executive Order 1996-5. The director of DMB has assigned to OSE the responsibility for the administration of SSGIF and all insurance benefits for State employees.

Five group insurance programs are currently offered to State employees: dental, vision, life, long-term disability (LTD), and health. Funding for the various insurance programs is based on the respective pay action determinations made by the Civil Service Commission and varies among employee groups. Retirees of the State of Michigan are offered dental, vision, life, and health group insurance programs.

For fiscal year 1996-97, DMB reported total expenses and operating transfers for SSGIF of \$584.6 million. As of September 30, 1997, the Employee Benefits Division of OSE and DMB had 12 employees.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial audit of the State Sponsored Group Insurance Fund (SSGIF), Office of the State Employer (OSE) and Department of Management and Budget (DMB), had the following objectives:

1. To assess the adequacy of SSGIF's internal control structure.
2. To assess SSGIF's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and DMB policies and procedures that could have a material effect on the financial statements.
3. To audit SSGIF's financial statements as of and for the fiscal years ended September 30, 1997 and September 30, 1996.

Our audit objective for the assessment of the internal control structure included an evaluation of DMB's implementation of the requirements for establishing and maintaining systems of internal accounting and administrative control, as set forth in Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws*.

Audit Scope

Our audit scope was to examine the financial and other records of the State Sponsored Group Insurance Fund for the period October 1, 1995 through September 30, 1997. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our report includes 2 findings and 2 corresponding recommendations. OSE's and DMB's preliminary response indicated that they agree and will comply with our recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require OSE and DMB to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

OSE and DMB had complied with all 4 of the prior audit recommendations.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the adequacy of the State Sponsored Group Insurance Fund's (SSGIF's) internal control structure.

Conclusion: Our assessment of SSGIF's internal control structure did not disclose any material weaknesses. However, we noted reportable conditions related to fund equity and report monitoring.

Also, our assessment indicated that the Department of Management and Budget (DMB) was in substantial compliance with the requirements set forth in Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws* pertaining to its systems of internal accounting and administrative control.

Noteworthy Accomplishments: In the period since OSE and DMB assumed program responsibility for SSGIF, a comprehensive accounting record was established for each of the five group insurance programs. This accounting record will facilitate the development of premium rates that reliably reflect the cost of benefits provided.

FINDING

1. Fund Equity

OSE and DMB should continue control measures to help ensure that insurance premiums are adjusted on a timely basis for programs within SSGIF.

Internal service fund charges are based on cost information over a reasonable period of time so that revenues and expenses are approximately equal for each of the programs. Surpluses in one program should not offset deficits in other programs. Federal requirements also preclude any charges in excess of costs and state that there are no provisions or intentions for profit or other increments above cost for SSGIF.

The long-term disability (LTD) and health insurance programs have reported significant negative and positive fund equity, respectively, during the past few years. The LTD insurance program reported negative fund equity for the last two fiscal years (1995-96 and 1996-97). As a result, SSGIF may not have adequate fund equity available should claim volume increase significantly and unexpectedly. The health insurance program reported positive fund equity for the last two fiscal years. As a result, SSGIF needs to make adjustments to reduce fund equity to an acceptable level. Our review of the LTD and health programs for active employees noted:

Program	Fiscal Year	Premium Rate Increase (Decrease) from Prior Year	Ending Fund Equity (in Millions)
LTD	1993-94	10%	\$ (29.9)
	1994-95	NC	\$ (43.5)
	1995-96	NC	\$ (50.4)
	1996-97	20%	\$ (51.2)
	1997-98	40%	
Health	1993-94	12%	\$ 0.0
	1994-95	NC	\$182.8
	1995-96	(14%)	\$191.7
	1996-97	(15%)	\$177.7
	1997-98	(22%)	

NC = no change in premium.

Based on this information, DMB did not sufficiently change rates to offset known deficits or surpluses for the past four fiscal years. DMB has monitored the fund equity since it assumed responsibility in July 1996; however, because of the timing of the rate setting processes, the effect of its changes had not been realized by SSGIF.

RECOMMENDATION

We recommend that OSE and DMB continue control measures to help ensure that insurance premiums are adjusted on a timely basis for programs within SSGIF.

AGENCY PRELIMINARY RESPONSE

OSE and DMB agree with the recommendation.

FINDING

2. Report Monitoring

OSE and DMB had not established control procedures to monitor the receipt and review of "SAS 70 reports" of its service organizations.

The American Institute of Certified Public Accountants issued Statement on Auditing Standards (SAS) No. 70, "Reports on the Processing of Transactions by Service Organizations," in April 1992. SAS 70 reports are issued on the internal control structure of service organizations by public accounting firms. The reports provide a description of control structure policies and procedures of the service organizations and include the independent auditor's opinion as to whether the policies and procedures are suitably designed to achieve specified control objectives and whether the policies and procedures had been placed in operation.

To help ensure that transactions processed by the service organizations are executed in accordance with management's authorization and are recorded properly, OSE and DMB should obtain and review the SAS 70 reports on the internal control structure of the service organizations.

The service organizations execute and record claims transactions involving SSGIF's dental, vision, life, LTD, and health insurances of State employees and retirees (\$445.3 million in claims payments for fiscal year 1996-97).

OSE and DMB requested these reports for 1996 and 1997 from 9 service organizations in October 1997. Only 3 of the service organizations submitted these reports to DMB (\$283.5 million in claims payments for fiscal year 1996-97). One of the other 6 service organizations submitted a report for 1995 (\$73.0 million in claims payments for fiscal year 1996-97), and the remaining 5 did not submit reports (\$88.8 million in claims payments for fiscal year 1996-97).

RECOMMENDATION

We recommend that OSE and DMB establish control procedures to monitor the receipt and review of SAS 70 reports of its service organizations.

AGENCY PRELIMINARY RESPONSE

OSE and DMB agree with the recommendation.

COMPLIANCE WITH LAWS AND REGULATIONS

COMMENT

Audit Objective: To assess SSGIF's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and DMB policies and procedures that could have a material effect on the financial statements.

Conclusion: Our assessment of SSGIF's compliance with applicable statutes, regulations, policies, and procedures did not disclose any instances of noncompliance that could have a material effect on the financial statements. We have no findings to report for this objective.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit SSGIF's financial statements as of and for the fiscal years ended September 30, 1997 and September 30, 1996.

Conclusion: We expressed an unqualified opinion on SSGIF's financial statements for the fiscal years ended September 30, 1997 and September 30, 1996. We have no findings to report for this objective.

Independent Auditor's Report on
the Internal Control Structure

March 31, 1998

Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan
and
Ms. Janine M. Winters, Director
Office of the State Employer
Knapps Centre
Lansing, Michigan

Dear Ms. Phipps and Ms. Winters:

We have audited the financial statements of the State Sponsored Group Insurance Fund, Office of the State Employer and Department of Management and Budget, as of and for the fiscal years ended September 30, 1997 and September 30, 1996 and have issued our report thereon dated March 31, 1998.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* 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 of material misstatement.

The management of the State Sponsored Group Insurance Fund and the management of the Office of the State Employer and Department of Management and Budget are responsible for establishing and maintaining an internal control structure, which operates in conjunction with the Statewide internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of

financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements for the fiscal years ended September 30, 1997 and September 30, 1996, we obtained an understanding of the State Sponsored Group Insurance Fund's internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State Sponsored Group Insurance Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are more fully described in Findings 1 and 2.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the State Sponsored Group Insurance Fund's reportable conditions described above is a material weakness.

AUDITOR GENERAL

Independent Auditor's Report on
Compliance With Laws and Regulations

March 31, 1998

Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan
and
Ms. Janine M. Winters, Director
Office of the State Employer
Knapps Centre
Lansing, Michigan

Dear Ms. Phipps and Ms. Winters:

We have audited the financial statements of the State Sponsored Group Insurance Fund, Office of the State Employer and Department of Management and Budget, as of and for the fiscal years ended September 30, 1997 and September 30, 1996 and have issued our report thereon dated March 31, 1998.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* 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 of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State Sponsored Group Insurance Fund is the responsibility of the Office of the State Employer and Department of Management and Budget management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the State Sponsored Group Insurance Fund's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

March 31, 1998

Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan
and
Ms. Janine M. Winters, Director
Office of the State Employer
Knapps Centre
Lansing, Michigan

Dear Ms. Phipps and Ms. Winters:

We have audited the accompanying balance sheet of the State Sponsored Group Insurance Fund, Office of the State Employer and Department of Management and Budget, as of September 30, 1997 and September 30, 1996 and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the fiscal years then ended. These financial statements are the responsibility of the State Sponsored Group Insurance Fund management and the Office of the State Employer and Department of Management and Budget management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1a, the accompanying financial statements present only the State Sponsored Group Insurance Fund and are not intended to present fairly the financial position and results of operations of the State of Michigan or its internal service funds.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the State Sponsored Group Insurance Fund as of September 30, 1997 and September 30, 1996 and the results of its operations and cash flows for the fiscal years then ended on the basis of accounting described in Note 1b.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 31, 1998 on our consideration of the Office of the State Employer's and the Department of Management and Budget's internal control structure and a report dated March 31, 1998 on their compliance with laws and regulations.

AUDITOR GENERAL

STATE SPONSORED GROUP INSURANCE FUND

Office of the State Employer and
Department of Management and Budget
Balance Sheet

As of September 30

	<u>1997</u>	<u>1996</u>
ASSETS		
Current Assets:		
Equity in Common Cash (Note 1)	\$ 186,426,702	\$ 165,905,507
Accounts receivable:		
Amounts due from other funds (Note 3)	24,649,302	56,770,441
Miscellaneous	3,243,575	4,702,604
	<u>\$ 214,319,579</u>	<u>\$ 227,378,552</u>
Noncurrent Assets:		
Deposits with insurer:		
Side fund (Note 4)	\$ 69,545,668	\$ 65,130,406
Special deposit	300,000	690,755
Advances to other funds (Note 3)	21,411,876	26,026,173
Property, plant, and equipment		
Equipment (cost)	303,309	303,309
Accumulated depreciation	(303,309)	(254,231)
Total property, plant, and equipment	<u>\$ 0</u>	<u>\$ 49,078</u>
	<u>\$ 91,257,544</u>	<u>\$ 91,896,412</u>
Total Noncurrent Assets	<u>\$ 91,257,544</u>	<u>\$ 91,896,412</u>
Total Assets	<u><u>\$ 305,577,123</u></u>	<u><u>\$ 319,274,964</u></u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Warrants outstanding	\$ 464,232	\$ 165,749
Accounts payable and other liabilities:		
Claim liabilities (Note 5)	69,623,253	62,204,030
Vouchers payable	22,742,496	9,341,659
Amounts due to other funds	21,604	23,764
Compensated absences	59,329	23,681
	<u>\$ 92,910,914</u>	<u>\$ 71,758,883</u>
Total Current Liabilities	<u>\$ 92,910,914</u>	<u>\$ 71,758,883</u>
Long-Term Liabilities:		
Compensated absences	\$ 311,914	\$ 106,054
Claim liabilities over two years (Note 5)	90,215,136	85,809,011
	<u>\$ 90,527,050</u>	<u>\$ 85,915,065</u>
Total Long-Term Liabilities	<u>\$ 90,527,050</u>	<u>\$ 85,915,065</u>
Total Liabilities	<u>\$ 183,437,964</u>	<u>\$ 157,673,948</u>
Retained Earnings - Unreserved (Note 6)	\$ 122,139,159	\$ 161,601,016
Total Fund Equity	<u>\$ 122,139,159</u>	<u>\$ 161,601,016</u>
Total Liabilities and Fund Equity	<u><u>\$ 305,577,123</u></u>	<u><u>\$ 319,274,964</u></u>

The accompanying notes are an integral part of the financial statements.

STATE SPONSORED GROUP INSURANCE FUND
Office of the State Employer and
Department of Management and Budget
Statement of Revenues, Expenses, and Changes in Retained Earnings
Fiscal Years Ended September 30

	<u>1997</u>	<u>1996</u>
OPERATING REVENUES		
Premium contributions	\$ 529,493,121	\$ 560,322,131
Interest earnings:		
Treasury deposits	11,937,116	12,544,059
Deposits with insurer	3,729,647	3,771,075
Miscellaneous receipts	<u>7,477,552</u>	<u>7,477,552</u>
 Total Operating Revenues	 \$ 545,159,884	 \$ 584,114,817
 OPERATING EXPENSES		
Claim payments	\$ 553,300,572	\$ 540,987,118
Service fees	28,422,150	29,365,866
Health Screening Unit	2,433,655	2,600,932
Depreciation	49,077	19,497
Other administrative expenses	<u>368,758</u>	<u>215,240</u>
 Total Operating Expenses	 \$ 584,574,212	 \$ 573,188,653
 Operating Income (Loss)	 \$ (39,414,328)	 \$ 10,926,164
 NONOPERATING EXPENSES		
Interest expense	<u>\$ (19,129)</u>	<u>\$</u>
 Total Nonoperating Expenses	 \$ (19,129)	 \$ 0
 Income (Loss) Before Operating Transfers	 \$ (39,433,457)	 \$ 10,926,164
 OPERATING TRANSFERS		
Operating transfers to other funds	<u>\$ (28,400)</u>	<u>\$</u>
 Total Operating Transfers Out	 \$ (28,400)	 \$ 0
 Net Income (Loss)	 \$ (39,461,857)	 \$ 10,926,164
 Retained Earnings - Beginning of fiscal year	 \$ 161,601,016	 \$ 150,674,851
 Retained Earnings - End of fiscal year	 <u>\$ 122,139,159</u>	 <u>\$ 161,601,016</u>

The accompanying notes are an integral part of the financial statements.

STATE SPONSORED GROUP INSURANCE FUND
Office of the State Employer and
Department of Management and Budget
Statement of Cash Flows
Fiscal Years Ended September 30

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income (loss)	\$ (39,414,328)	\$ 10,926,164
Adjustments to reconcile operating income with net cash provided (used) by operating activities:		
Depreciation	49,077	19,498
Interest (nonprogram) and investment income		(3,741,693)
Changes in assets and liabilities:		
Amounts due from other funds	36,735,436	(46,187,836)
Other assets	(2,565,478)	(3,828,871)
Accounts payable and other liabilities	25,467,694	(5,701,518)
Amounts due to other funds	(2,160)	14,063
	\$ 20,270,241	\$ (48,500,193)
 CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers to other funds	\$ (28,400)	\$
Net Cash Provided (Used) by Noncapital Financing Activities	\$ (28,400)	\$ 0
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Interest expense	\$ (19,129)	\$
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (19,129)	\$ 0
 CASH FLOWS FROM INVESTING ACTIVITIES		
Net Cash Provided (Used) - All Activities	\$ 20,222,712	\$ (48,500,193)
Cash and cash equivalents at beginning of year	165,739,758	214,239,951
	\$ 185,962,470	\$ 165,739,758
 RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per balance sheet classifications:		
Equity in Common Cash	\$ 186,426,702	\$ 165,905,507
Warrants outstanding	(464,232)	(165,749)
	\$ 185,962,470	\$ 165,739,758

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and results of operations of the State Sponsored Group Insurance Fund, Office of the State Employer and Department of Management and Budget, as of and for the fiscal years ended September 30, 1997 and September 30, 1996. They are not intended to present the financial position and results of operations of the State of Michigan or its internal service funds.

The State Sponsored Group Insurance Fund is a part of the State of Michigan's reporting entity and is reported as an internal service fund in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

The footnotes accompanying these financial statements relate directly to the State Sponsored Group Insurance Fund. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies, Budgeting and Budgetary Control, Treasurer's Common Cash, and Pension Benefits and Other Postemployment Benefits.

b. Basis of Accounting and Presentation

The financial statements contained in this report are prepared on the accrual basis of accounting. The accrual basis of accounting, which emphasizes the measurement of total financial position and results of operations, is explained in more detail in the *SOMCAFR*.

c. Fund Cash Account

A single cash account is maintained by the Fund for use by all the insurance programs. Premiums collected are deposited into the cash account and invested as part of the State Treasurer's Common Cash. Claim payments and administrative expenses are paid from the cash account. Because a single account is used, an individual insurance

program can have a deficit cash balance while the Fund in total has a positive cash balance.

Note 2 Description of Fund

The State Sponsored Group Insurance Fund was administratively established to account for employee and retiree insurance benefit programs, which are largely self-funded. Five group insurance programs are offered to State employees: dental, vision, life, long-term disability, and health. All State retirees are offered these same programs, with the exception of long-term disability.

To participate in these programs, an employee must be appointed for at least 720 hours and be either full-time or at least 40% part-time. (The 40% requirement does not apply to the health program.) Funding for the various insurance programs is based on the respective pay action determinations made by the Civil Service Commission and does vary among employee groups. In general, funding for each program is as follows:

- a. Dental insurance is funded 95% and 5% by the State and the employee, respectively, and 90% and 10% by the State and the retiree, respectively.
- b. The State contributes 100% for vision insurance for employees. Vision insurance is funded 90% and 10% by the State and the retiree, respectively.
- c. The State contributes 100% for employee and retiree life insurance coverage, and the employee and retiree contributes 100% for dependent life insurance coverage.
- d. Contribution rates for long-term disability insurance vary depending on the unused hours of sick leave accumulated by the employee. However, in total, long-term disability is funded 60% and 40% by the State and the employee, respectively.
- e. The State Health Plan is funded 95% and 5% by the State and the employee/retiree, respectively. The State contributes 100% of the cost for

retirees age 65 or older. The State contributes 100% of the cost for those employees enrolled in health maintenance organizations as long as the overall cost does not exceed 95% of the cost of the State Health Plan.

More specific information concerning eligibility requirements, benefit level, and funding policies is included in employee collective bargaining agreements, benefit plan booklets, and rules and regulations issued by the Civil Service Commission.

Note 3 Interfund Receivables

The statements report interfund receivables of \$46,061,178 and \$82,796,614 for fiscal years 1996-97 and 1995-96, respectively. These receivables are primarily composed of amounts temporarily loaned to another internal service fund or the State's General Fund to cover cash shortages. These loans occurred on September 30, 1997 and September 30, 1996, respectively, and were returned on October 1, 1997 and October 1, 1996, respectively. These loans can take place because all funds involved are participating members of the State Treasurer's Common Cash.

Note 4 Split Funded Disability Deposit Side Fund

This Fund was established to fund the plan liabilities for disabilities extending beyond two years. The statements disclose side fund deposits with a service organization of \$69,545,668 and \$65,130,406 for fiscal years 1996-97 and 1995-96, respectively. Effective January 1, 1993 and thereafter, the interest assumption rate was changed to 6.0%.

Note 5 Claim Liabilities

Expenses and liabilities for incurred but not reported or not processed benefit claims, based on estimates from the plan administrators, have been recorded as liabilities in the amount of \$159,838,389 and \$148,013,041 for fiscal years 1996-97 and 1995-96, respectively. Each of the various insurance carriers has a professional actuary staff which estimates these amounts based on the program's past experience. The short-term portion of \$69,623,253 and \$62,204,030 for fiscal years 1996-97 and 1995-96, respectively, are based on claims information received from plan administrators. The long-term portion, related to the long-term disability program, is reported at a discounted present

value of \$90,215,136 and \$85,809,011 for fiscal years 1996-97 and 1995-96, respectively, using a discount rate of 10.5% (first 15 years of disability), 9.0% (next 5 years), and 6.0% (thereafter) for claims incurred prior to January 1, 1992. Claims incurred in 1992 were discounted using a rate of 9.0% (first 20 years of disability) and 6.0% (thereafter). Claims incurred in 1993 and 1994 were discounted using a rate of 6.0%. Claims incurred in 1995 were discounted using a rate of 6.25%. Claims incurred in 1996 and 1997 were discounted using a rate of 5.75%.

Note 6 Unreserved Retained Earnings

The statements disclosed unreserved retained earnings balances of \$122,139,159 and \$161,601,016 for fiscal years 1996-97 and 1995-96, respectively. Unreserved retained earnings represent fund and employee contributions in excess of recognized expenses and amounts required at the benefit program level. For September 30, 1997 a portion of the retained earnings has been designated for catastrophic losses in the amount of \$40,241,100.

Note 7 Subsequent Event

In January 1998, the employee share of premium contributions for State-sponsored health insurance (Blue Cross and Blue Shield of Michigan) was suspended for ten pay periods. This will result in a decrease of approximately \$62 million of contributions and a reduction in fund balance for fiscal year 1997-98.

Glossary of Acronyms and Terms

DMB	Department of Management and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are fairly presented in conformity with generally accepted accounting principles.
internal control structure	The management control environment, accounting system, and control policies and procedures established by management to provide reasonable assurance that resources are safeguarded; that resources are used in compliance with laws and regulations; and that financial transactions are properly accounted for and reported.
LTD	long-term disability.
material weakness	A serious reportable condition in which the design or operation of one or more of the internal control structure elements (including management controls) does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, would not be prevented or detected.
OSE	Office of the State Employer.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure.
SAS	Statement on Auditing Standards.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

SSGIF

State Sponsored Group Insurance Fund.