

State Sponsored Group Insurance Fund

Financial Statements for Fiscal Year Ended September 30, 2020



Prepared by
The Michigan Civil Service
Commission
Employee Benefits Division
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Table of Contents

	Page
Independent Auditors' Report	1
Basic Financial Statements	
Statement of Net Position	3
Statement of Revenues, Expenses and Changes in Net Position	4
Statement of Cash Flows	5
Notes to the Financial Statements	6



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Office of the Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

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

Mr. Brom Stibitz, Director
Department of Technology, Management, and Budget
Elliott-Larsen Building
Lansing, Michigan

Ms. Janine M. Winters, State Personnel Director
Michigan Civil Service Commission
Capitol Commons Center
Lansing, Michigan

Dear Mr. Stibitz and Ms. Winters:

Report on the Financial Statements

We have audited the accompanying financial statements of the State Sponsored Group Insurance Fund (SSGIF), a proprietary fund of the State of Michigan, as of and for the fiscal year ended September 30, 2020 and the related notes to the financial statements, which collectively comprise SSGIF's financial statements as listed in the table of contents.

Management's Responsibility 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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* 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 accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



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Page 2

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 in the first paragraph present fairly, in all material respects, the financial position of the State Sponsored Group Insurance Fund as of September 30, 2020 and the changes in financial position and cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the financial statements present only SSGIF and do not purport to, and do not, present fairly the financial position of the State of Michigan or its internal service funds as of September 30, 2020, the changes in its financial position, or, where applicable, its cash flows for the fiscal 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 will also issue a report on our consideration of SSGIF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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 SSGIF'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* in considering SSGIF's internal control over financial reporting and compliance.

Sincerely,

Doug Ringler
Auditor General
January 7, 2021

State Sponsored Group Insurance Fund
Statement of Net Position
As of September 30, 2020

Assets

Current assets:

Cash	\$ 1,560
Equity in common cash (Note 3)	390,038,232
Accounts receivable:	
Amounts due from other funds (Note 4)	10,996,272
Amounts due from component units (Note 4)	122,638
Miscellaneous - net (Note 5)	<u>6,937,095</u>

Total current assets 408,095,797

Other noncurrent assets (Note 6) 1,700,000

Total assets \$ 409,795,797

Liabilities and Net Position

Current liabilities:

Accounts payable and other liabilities:

Claim liabilities (Note 7)	\$ 34,239,483
Vouchers payable	17,355,423
Unearned revenue	<u>122,604</u>

Total current liabilities 51,717,511

Long-term liabilities:

Claim liabilities (Note 7) 93,095,855

Total liabilities 144,813,365

Net Position

Unrestricted (Note 8) 264,982,432

Total liabilities and net position \$ 409,795,797

State Sponsored Group Insurance Fund
Statement of Revenues, Expenses, and Changes in Net Position
For the Fiscal Year Ended September 30, 2020

Operating revenues

Premium contributions	<u>\$ 793,622,189</u>
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Operating expenses

Claim payments and premiums	743,077,360
Service fees and other administrative expense	<u>20,491,443</u>

Total operating expenses	<u>763,568,803</u>
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Operating income	30,053,385
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Nonoperating revenues

Interest revenues	3,533,974
Other	<u>1,141</u>

Change in net position	33,588,501
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Net position at beginning of fiscal year	<u>231,393,931</u>
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Net position at end of fiscal year	<u><u>\$ 264,982,432</u></u>
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State Sponsored Group Insurance Fund
Statement of Cash Flows
For the Fiscal Year Ended September 30, 2020

Cash flows from operating activities

Cash received from customers	\$ 790,336,314
Payments to suppliers	(5,429,358)
Claims paid	<u>(760,916,760)</u>

Net cash used by operating activities	<u>23,990,196</u>
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Cash flows from investing activities

Interest on equity in common cash	<u>3,533,974</u>
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Net increase in cash and cash equivalents	27,524,170
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Cash and cash equivalents at beginning of fiscal year	<u>362,515,622</u>
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Cash and cash equivalents at end of fiscal year	<u><u>\$ 390,039,792</u></u>
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**Reconciliation of operating income to net cash provided
by operating activities**

Operating income	\$ 30,053,385
Adjustments to reconcile operating income with net cash used by operating activities	
Other nonoperating revenues	1,141
Changes in assets and liabilities	
Amounts due from other funds and component units	(2,789,230)
Miscellaneous receivables	(1,544,175)
Accounts payable and other liabilities	<u>(1,730,926)</u>

Net cash used by operating activities	<u><u>\$ 23,990,196</u></u>
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Reconciliation of cash and cash equivalents

Cash	\$ 1,560
Equity in common cash	<u>390,038,232</u>

Cash and cash equivalents at end of fiscal year	<u><u>\$ 390,039,792</u></u>
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State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Note 1 Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements report the financial position, changes in financial position, and cash flows of the State Sponsored Group Insurance Fund, a proprietary fund of the State of Michigan, as of and for the fiscal year ended September 30, 2020. They are not intended to present the financial position, changes in financial position, and cash flows of the State of Michigan or its internal service funds in conformity with accounting principles generally accepted in the United States of America. The State Sponsored Group Insurance Fund 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 disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; common cash; pension benefits; and other postemployment benefits.

Measurement Focus, Basis of Accounting, and Presentation

The financial statements contained in this report are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Rebates, adjustments, and other related receipts are netted against expense. Operating revenues and expenses generally result from providing insurance benefits. All other revenues and expenses are reported as nonoperating.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenditures during the reporting period. Actual results could differ from those estimates.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

As allowed by Governmental Accounting Standards Board (GASB) Statement No. 62, *GASB Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

State Sponsored Group Insurance Fund Cash Account

The Fund utilizes the State Treasurer's Common Cash pool as its primary cash account for the insurance programs it administers. For the purposes of the statement of cash flows, the Fund considers cash and equity in the State's Treasurer's Common Cash pool to be cash equivalents. Premiums collected are deposited, and claim payments and administrative expenses are paid from this account. Because a single account is used, an individual insurance program can have a deficit cash balance while the Fund in total can have a positive cash balance.

Note 2 Description of the State Sponsored Group Insurance Fund

The Fund was administratively established to account for employee insurance benefit programs, which are largely self-funded. Five group insurance programs are offered to State employees: health, dental, vision, long-term disability, and life.

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 varies among employee groups. In general, funding for each program is as follows:

- Health insurance is funded based upon an employee's hire date and union code. The State Health Plan is funded 80% and 20% by the State and the employee, respectively. The State contributes a maximum of 85% of the cost for those employees enrolled in health maintenance organizations up to the amount paid for the same coverage under the State Health Plan.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

- Effective October 31, 2010, C.O.P.S. Trust (Coalition of Public Safety Employees Health Trust) became available only to MSPTA (State Police) represented employees. This is an optional health insurance plan and this new plan did not replace the State's current PPO and HMO plans.
- Effective October 1, 2011, the State of Michigan offered health insurance to Other Eligible Adult Individuals (OEAI)s to elected unions through the collective bargaining process. Employees currently represented by MSEA, UAW Local 6000, SEIU Local 517 M, and NEREs may enroll one OEAI.
- Dental insurance is funded 95% and 5% by the State and the employee, respectively.
- The State contributes 100% for vision insurance for employees.
- 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 50% and 50% by the State and the employee, respectively.
- The State contributes 100% for employee life insurance coverage, and the employee contributes 100% for dependent life insurance coverage.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* prohibits the reporting of retiree related postemployment benefits within the State Sponsored Group Insurance Fund. No retiree related activity, including accumulated net position, is reflected in this report. The retiree activity is recorded in certain other employee benefit trust funds in the *SOMCAFR*.

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.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Note 3 Equity in the State Treasurer's Common Cash

Equity in the State Treasurer's Common Cash pool represents the State Sponsored Group Insurance Fund's interest, at market, in an investment pool managed by the State Treasurer.

The investment authority for the Common Cash pool is found in Act 105, P.A. 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States government or its agencies and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State of Michigan.

The State Sponsored Group Insurance Fund's pro-rata share of the State Treasurer's Common Cash pool was \$390,038,232 at September 30, 2020. For the total amount of deposits and investments in the State Treasurer's Common Cash pool and their specific risks, please refer to the *SOMCAFR*.

Common Cash Deposits

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

- a. Uncollateralized,
- b. Collateralized with securities held by the pledging financial institution, or
- c. Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

The State Treasurer's Common Cash pool policy requires the following criteria to lessen the custodial credit risk: All financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits, to secure the State's funds; a bank, savings and loan association, or credit union holding the State's funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan; and no deposit in any financial organization may be in excess of 50% of the net worth of the organization.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Act 35, P.A. 1997, requires State deposits to be held in a financial institution that maintains a principal office or branch office located in the State of Michigan. The State had no Common Cash pool deposits subject to foreign currency risk at September 30, 2020.

Common Cash Investments

Types of Investments

State Treasurer's Common Cash pool investments can include prime commercial paper, certificate of deposits, and emergency municipal notes.

Risk

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. The custodial credit risk, the credit risk, the interest rate risk, the concentration of credit risk, and the foreign currency risk are discussed in the following paragraphs.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure by a counterparty, the State Sponsored Group Insurance Fund will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

- a. The counterparty or
- b. The counterparty's trust department or agent, but not in the government's name.

The State Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2020, Common Cash pooled investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

The State Treasurer requires that prime commercial paper investments be rated within one of the two highest ratings classifications ("1" or "2") at the time of purchase from one of the nationally recognized ratings organizations (NRSROs) specified in Public Act 314 of 1965, as amended. Borrowers must have at least \$400.0 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of the borrower's outstanding debt.

The State Treasurer's investment in emergency municipal loans is evidenced by unrated notes held by the State in the State's name. In addition, at September 30, 2020, prime commercial paper investments were rated at A-1, P-1, or above.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's Common Cash pool policy states that cash equivalents are to be invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

The State Treasurer does not have a policy for controlling interest rate risk regarding the Common Cash pool investments in the special loan program (Emergency Financial Assistance Loan Program). These loan programs are investments created through legislation. Although some interest rate risk exposure exists, interest rate risk is not a consideration when entering into the special loan programs.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of a government's investment with a single issuer.

The State Sponsored Group Insurance Fund is invested in pooled investments in the State of Michigan Common Cash pool, which is excluded from concentration of credit risk disclosure requirements.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

The State Treasurer's Common Cash pool investment policy does not allow for investment in foreign investments or currency; therefore, the State Sponsored Group Insurance Fund is not exposed to foreign currency risk.

Note 4 Interfund Receivables

The statement of net position includes interfund receivables totaling \$11,118,910 at September 30, 2020. These receivables are composed of the amounts assessed for insurance accruals relating to the last pay period of the fiscal year and amounts due from component units.

Note 5 Miscellaneous Receivables and Revenues

The statement of net position includes miscellaneous receivables of \$6,937,095 at September 30, 2020. These receivables are predominately composed of amounts anticipated to be received from third party administrators for activity such as rebates and settlements.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Included in miscellaneous receivables are amounts recorded for overpayments to claimants who were eligible to receive long-term disability benefits but later were awarded Social Security disability and/or pension disability benefits retroactive to periods initially covered by long-term disability. At September 30, 2020, the receivable balance for these overpayments and related allowance for doubtful accounts totals \$6,628,194 and \$4,841,536 respectively. A decrease to the allowance for doubtful accounts in the amount of \$24,824 was recognized during the year against operating expenses.

Note 6 Other Noncurrent Assets

Two third party administrators requested a working capital advance at the start of the contract totaling \$1,700,000 and will hold these advances throughout the entire length of the contract. The advances will be classified as current assets one year from the end of the contracts. None of the advances were classified as a current asset in miscellaneous receivable as of September 30, 2020.

Note 7 Claim Liabilities

Expenses and liabilities for incurred claims and incurred but not reported or not processed claims, based on estimates from the plan administrators, have been recorded as liabilities in the amount of \$127,335,338 at September 30, 2020. The short-term portion of \$34,239,483 at September 30, 2020, is based on claims information received from plan administrators. Each of the various insurance carriers, with the exception of the long-term disability provider, has professional actuarial staff or outside professional contractors that estimate these amounts based on the programs past experience.

The long-term disability program estimates the incurred and incurred but not reported or not processed liability using actuarial principles, the program's past experience, and information from prior actuary studies. The long-term portion, related to the long-term disability program, is reported at a discounted present value of \$92,846,279 at September 30, 2020. For all claims incurred prior to October 1, 2020, the discounted present value of the long-term disability liability was calculated over a 20-year period using a discount rate of approximately 0.80%. The remaining long-term claim liability of \$249,576 pertains to health care and behavioral health insurance programs.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Changes in the State Sponsored Group Insurance Fund's claim liability for employee insurance benefit programs for the fiscal years ended September 30, 2020 and 2019, are as follows:

Beginning balance – October 1, 2018	\$ 134,970,988
Current year claims, premiums, and changes	729,827,020
Claims payments and premiums paid	<u>(733,746,384)</u>
Ending balance – September 30, 2019	\$ 131,051,624
Current year claims, premiums, and changes	727,163,237
Claims payments and premiums paid	<u>(730,879,523)</u>
Ending balance – September 30, 2020	<u><u>\$ 127,335,338</u></u>

Note 8 Unrestricted Net Position

The statement of net position includes an unrestricted net position balance of \$264,982,432 at September 30, 2020. Unrestricted net position represents employer and employee contributions in excess of recognized expenses and amounts required at the benefit program level. Recommended net position surpluses to cover catastrophic losses of the State Sponsored Group Insurance Fund (based on target funding levels suggested by the State Sponsored Group Insurance Fund's benefits consultants) were \$37,722,805 at September 30, 2020.

Note 9 Commitments and Contingencies

The State Sponsored Group Insurance Fund has contracted with various third parties to administer the group insurance programs offered to State employees. The current contracts expire on different dates ranging from December 31, 2020, through December 31, 2022.

From time to time, the Fund is party to lawsuits and claims arising in the normal course of business. When this occurs, the Fund has defended and intends to continue to defend these actions vigorously and believes, based on currently available information, that adverse settlements, if any, will not be material to its financial position or results of operations.

State Sponsored Group Insurance Fund
Notes to the Financial Statements
September 30, 2020

Note 10 Risk Management

The Fund is exposed to various risks related to general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment insurance claims. The State of Michigan has elected not to purchase commercial insurance for many of the risks of losses to which the Fund is exposed, but to self-insure for such risks. More detailed information on risk management is available in the State of Michigan's Comprehensive Annual Financial Report.