

SDML Workers' Compensation Fund

Financial Statements
With Supplementary Information
With Independent Auditor's Report Thereon
December 31, 2018 and 2017

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RSM US LLP

Independent Auditor's Report

Board of Trustees
SDML Workers' Compensation Fund

Report on the Financial Statements

We have audited the accompanying financial statements of South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund) as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Fund's basic 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, 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.

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 financial position of SDML Workers' Compensation Fund as of December 31, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedule of claims development information on Page 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the schedule of claims development information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 27, 2019, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

RSM US LLP

Sioux Falls, South Dakota
June 27, 2019

SDML Workers' Compensation Fund

Statements of Net Position December 31, 2018 and 2017

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 4,418,344	\$ 3,185,786
Investments (Note 2 and 3):		
Certificates of deposit	7,082,193	5,783,925
Receivables:		
Reinsurance recoverable on paid losses (Notes 5 and 7)	411,955	322,699
Member contributions	119,468	133,193
Investment income	88,794	80,990
Other	39,239	24,761
Prepaid expenses	-	3,795
Total current assets	12,159,993	9,535,149
Long-term investments (Notes 2 and 3):		
Certificates of deposit	20,808,403	22,077,843
Debt securities	1,540,813	1,609,234
Total long-term investments	22,349,216	23,687,077
Other assets:		
Contributed surplus and member equity in NLC Mutual Insurance Company (Note 6)	2,029,717	1,960,132
	\$ 36,538,926	\$ 35,182,358
Liabilities and Net Position		
Current liabilities:		
Current portion of estimated liability for reported and unreported claims and claims adjustment expenses (Notes 5 and 7)	\$ 3,794,195	\$ 3,199,816
Advance member contributions	2,420,362	2,591,901
Member contributions refundable	683,092	567,950
Accounts payable and accrued expenses	27,705	27,208
Total current liabilities	6,925,354	6,386,875
Estimated liability for reported and unreported claims and claims adjustment expenses, less current portion (Notes 5 and 7)	5,861,399	5,317,100
Total liabilities	12,786,753	11,703,975
Net position (Note 9):		
Unrestricted	23,752,173	23,478,383
	\$ 36,538,926	\$ 35,182,358

See notes to financial statements.

SDML Workers' Compensation Fund

Statements of Revenues, Expenses and Changes in Net Position Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenues:		
Member contributions earned, net of renewal and loss control credits (Note 9)	\$ 7,747,166	\$ 7,352,457
Less reinsurance premiums (Note 5)	<u>(653,133)</u>	<u>(628,590)</u>
Net operating revenues	<u>7,094,033</u>	<u>6,723,867</u>
Operating expenses:		
Claims and claims adjustment expenses incurred, net (Notes 4, 5 and 7)	<u>5,715,189</u>	4,471,036
General and administrative expenses:		
Administrative and service fees (Notes 4 and 8)	955,162	917,160
Payroll audit fees	39,914	38,564
Professional fees	40,576	50,456
Board of Trustee fees and expenses	22,925	26,233
Actuarial fees	17,350	17,350
Office expense and other	9,739	9,665
Insurance expense	3,103	3,214
Total general and administrative expenses	<u>1,088,769</u>	<u>1,062,642</u>
Return on equity credits (Note 9)	<u>598,330</u>	546,040
Total operating expenses	<u>7,402,288</u>	<u>6,079,718</u>
Operating income (loss)	<u>(308,255)</u>	<u>644,149</u>
Nonoperating revenues:		
Net investment income (Note 4)	512,460	395,835
Earned member equity, NLC Mutual Insurance Company (Note 6)	69,585	66,285
Total nonoperating revenues	<u>582,045</u>	<u>462,120</u>
Change in net position	273,790	1,106,269
Net position:		
Beginning of year	<u>23,478,383</u>	<u>22,372,114</u>
End of year	<u>\$ 23,752,173</u>	<u>\$ 23,478,383</u>

See notes to financial statements.

SDML Workers' Compensation Fund

Statements of Cash Flows Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Contributions received	\$ 7,704,494	\$ 7,569,752
Reinsurance premiums paid	(664,584)	(75,457)
Underwriting and expenses of operations paid	(1,088,271)	(1,066,597)
Claims and claims adjustment expenses paid	(4,665,000)	(4,888,690)
Dividends to members	(598,330)	(546,040)
Net cash provided by operating activities	688,309	992,968
Cash flows from investing activities:		
Debt securities:		
Sales and maturities	-	499,471
Certificates of deposit:		
Purchases	(8,303,000)	(10,750,000)
Sales and maturities	8,274,172	8,565,702
Investment income received, net of investment expenses	573,077	726,865
Net cash provided by (used in) investing activities	544,249	(957,962)
Net increase in cash and cash equivalents	1,232,558	35,006
Cash and cash equivalents:		
Beginning of year	3,185,786	3,150,780
End of year	<u>\$ 4,418,344</u>	<u>\$ 3,185,786</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ (308,255)	\$ 644,149
(Increase) decrease in assets:		
Reinsurance recoverable on paid losses	(89,256)	(16,545)
Member contributions receivable	13,725	(24,730)
Other receivables	(14,478)	(1,208)
Prepaid expenses	3,795	584,546
Increase (decrease) in liabilities:		
Estimated liability for reported and unreported claims and claims adjustment expenses	1,138,678	(401,314)
Advance member contributions	(171,539)	178,514
Member contributions refundable	115,142	63,511
Accounts payable and accrued expenses	497	(33,955)
Net cash provided by operating activities	\$ 688,309	\$ 992,968
Supplemental disclosures of noncash investing and financing activities:		
Net decrease in the fair value of investments	<u>\$ 68,422</u>	<u>\$ 347,233</u>

See notes to financial statements.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Reporting entity: South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund) was formed in 1986 to provide workers' compensation coverage for member organizations belonging to SDML and the South Dakota Association of County Commissioners (SDACC). There were 493 and 454 members of the Fund in 2018 and 2017, respectively, all of which are primarily cities, counties, townships and special districts of the state of South Dakota. The objective of the Fund is to formulate, develop and administer, on behalf of member organizations, a program of workers' compensation coverage; to obtain lower costs for that coverage; and to develop a comprehensive loss control program. The Fund is supervised by a nine-member Board of Trustees.

The Fund operates as a single proprietary fund, more specifically as an enterprise fund. The Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Fund's principal ongoing operations. Nonoperating revenues and expenses result primarily from investment activities.

The Fund is exposed to various risks of loss related to torts and errors and omissions. SDML has purchased commercial insurance to mitigate these risks.

Members agree to continue membership in the Fund for one year and may withdraw from the Fund for any year thereafter upon giving 60 days written notice to the Fund manager. Withdrawal cannot take place prior to the end of the policy year. Any member whose membership has been terminated by the Fund will only retain an interest to any accrued or current excess contributions as determined by the Board of Trustees.

A summary of the Fund's significant accounting policies follows:

Basis of presentation: The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting.

Use of estimates: The preparation of financial statements 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. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the estimated liability for reported and unreported claims and claims adjustment expenses, amounts recoverable from reinsurers under excess of loss and aggregate agreements, and the determination of estimated fair values of investments.

Cash and cash equivalents: For purposes of reporting the statements of cash flows, the Fund includes as cash equivalents all cash accounts and money market mutual funds that are not subject to withdrawal restrictions or penalties and have a maturity of three months or less at the date of acquisition.

Receivables: Receivables are recorded based on amounts due from members and other third-party payers, and amounts estimated to be received or recovered from reinsurers and other third-party payers. The Fund evaluates the collectibility of such receivables monthly based on third-party payers' financial condition and credit history, and current economic conditions. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Investments: The Fund reports investments (other than nonnegotiable certificates of deposit) at fair value in the statements of net position with changes in the fair value of investments reported as investment income. Fair value is the price that would be received to sell the investment in an orderly transaction between market participants at the measurement date. Fair value of actively traded securities is determined by the reported market value of securities trading on national exchanges. Values of securities not actively traded are based on observable inputs of similar financial instruments. Nonnegotiable certificates of deposit are stated at cost.

Dividend and interest income is recognized when earned. Investment expenses are netted against investment income.

The calculation of realized gains and losses is independent of the calculation of the net increase (decrease) in the fair value of investments. Realized gains and losses on investments that had been held for more than one year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year.

Member equity in NLC Mutual Insurance Company: The Fund records its share of net increases (decreases) in certain net assets of NLC Mutual Insurance Company as income (loss) in the Fund's statements of revenues, expenses and changes in net position and adds (deducts) such amounts to (from) the investment account.

Reinsurance: In the normal course of business, the Fund seeks to reduce the loss that may arise from events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Amounts recoverable from reinsurers under excess loss coverages are estimated in a manner consistent with the development of the estimated liability for reported and unreported claims and claims adjustment expenses. Amounts recoverable from reinsurers that relate to paid claim losses and loss adjustment expenses are classified as assets, net of an allowance for any estimated uncollectible amounts, and as a reduction to claims expenses incurred. Estimated amounts recoverable from reinsurers that relate to unpaid claim losses and loss adjustment expenses are recorded as a reduction of insurance liabilities and claims expenses incurred. Reinsurance premiums paid and reinsurance recoveries on claims are netted against related earned member contributions and claims and claims adjustment expenses incurred, respectively.

Income taxes: The Fund's management believes that its income is excludable from income tax under section 115 of the Internal Revenue Code. A private letter ruling on the Fund's tax-exempt status has not been requested.

Member contributions and unearned income: Members are billed annually in advance for a deposit contribution. After the end of the policy year, members are billed for (refunded) any additional (excess) contributions as a result of payroll audits. Income from such contributions is recorded as earned during the coverage period. Contributions received in advance for coverage in the following policy year are recorded as advance member contributions. Revenue is reduced by reinsurance premiums ceded to the reinsurance company. Member contributions are recorded net of renewal and loss control credits (see Note 9).

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Contribution deficiency: A contribution deficiency exists when the sum of expected claims costs (including an estimated liability for unreported claims) and all expected claims adjustment expenses, expected dividends, and policy acquisition costs exceed related unearned premiums. The Fund anticipates investment income in determining if a contribution deficiency exists. At December 31, 2018 and 2017, the Fund determined no contribution deficiency existed.

Estimated liability for reported and unreported claims and claims adjustment expenses: The coverage offered by the Fund is on an occurrence basis, which provides for payment of claims that occur during the period of coverage regardless of when the claim is reported. The estimated liability for reported and unreported claims and claims adjustment expenses is based upon data developed by the Fund's administrator and is discounted at a rate of 1.75% as of December 31, 2018 and 2017, which had the effect of reducing this liability as of December 31, 2018 and 2017, by approximately \$634,000 and \$591,000, respectively. Industry experience and statistics were used to develop the estimated liability. The claims history of the Fund was also considered. The liability includes estimates of the costs to settle individual claims that have been reported, plus a provision for claims and costs incurred but not yet reported. A provision for inflation in the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Claims are reduced for subrogation when payment is received, as subrogation amounts are immaterial.

As adjustments to this estimated liability become necessary, such adjustments are reflected in current operations. Management of the Fund believes the estimated liability for reported and unreported claims and claims adjustment expenses is sufficient to cover the ultimate net cost of incurred claims, but such reserves are based on estimates, and the ultimate liability may be greater or less than the amounts estimated. An independent actuary assisted management with the establishment of estimated claims liabilities at December 31, 2018 and 2017.

Note 2. Deposits and Investments

The Fund's deposits as of December 31, 2018 and 2017, consist of cash, money market funds and certificates of deposit with book balances totaling \$32,308,940 and \$31,047,554, respectively.

Custodial credit risk—deposits: Custodial credit risk for deposits is the risk that in the event of a bank failure, the Fund's deposits may not be returned to it. The Fund's deposit policy limits maturities of certificates of deposit to no greater than five years. In addition, the investment policy allows the Fund to be invested in certificates of deposit of banks or savings and loan associations organized under the laws of the United States of America and any state thereof that are insured by the Federal Deposit Insurance Corporation or any similar organization. The Fund's investment policy also states that no certificate of deposit may be for a face amount greater than \$250,000. As of December 31, 2018 and 2017, deposits of \$1,198,866 and \$997,362, respectively, were exposed to custodial credit risk, as they were uninsured, and the collateral was held by the pledging bank not in the Fund's name.

Custodial credit risk—investments: The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (i.e., broker-dealer) to a transaction, the Fund will not be able to recover the value of its investments that are in the possession of another party. The Fund does not have a policy regarding exposure to custodial credit risk. At December 31, 2018 and 2017, no investments were exposed to custodial credit risk.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 2. Deposits and Investments (Continued)

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Fund limits investments in United States government-backed mortgage pools to an average life no greater than 12 years as a means of managing exposure to fair value losses arising from increasing interest rates.

As of December 31, 2018, the Fund had the following fixed-income securities and maturities:

Investment Type	Fair Value/ Carrying Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. Treasury issues	\$ 1,540,813	\$ -	\$ 1,170,079	\$ 370,734	\$ -
Negotiable certificates of deposit	8,053,750	1,246,000	6,807,750	-	-
	9,594,563	1,246,000	7,977,829	370,734	-
Nonnegotiable certificates of deposit	19,836,846	5,836,193	14,000,653	-	-
Total	<u>\$ 29,431,409</u>	<u>\$ 7,082,193</u>	<u>\$ 21,978,482</u>	<u>\$ 370,734</u>	<u>\$ -</u>

As of December 31, 2017, the Fund had the following fixed-income securities and maturities:

Investment Type	Fair Value/ Carrying Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. Treasury issues	\$ 1,609,234	\$ -	\$ -	\$ 1,223,125	\$ 386,109
Negotiable certificates of deposit	4,819,750	988,000	3,831,750	-	-
	6,428,984	988,000	3,831,750	1,223,125	386,109
Nonnegotiable certificates of deposit	23,042,018	4,795,925	18,246,093	-	-
Total	<u>\$ 29,471,002</u>	<u>\$ 5,783,925</u>	<u>\$ 22,077,843</u>	<u>\$ 1,223,125</u>	<u>\$ 386,109</u>

The net decrease in the fair value of investments during 2018 and 2017 was \$68,422 and \$347,233, respectively. These amounts take into account all changes in fair value (including purchases and sales) that occurred during the year. Gross realized investment gains were \$- and \$302,530 and gross realized investment losses were \$21,202 and \$38,853 for the years ended December 31, 2018 and 2017, respectively. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that have been held for more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior year and current year.

Credit risk: The Fund's approved investment policy and South Dakota Codified Law (SDCL) 4-5-6 authorize the Fund to be invested only in (a) securities of the United States and securities guaranteed by the United States government, either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) above and repurchase agreements described in (b) above. The Fund has no investment policy that would further limit its investment choices other than as described in its investment footnote disclosures.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 2. Deposits and Investments (Continued)

Concentration of credit risk: The Fund's investment policy states that no individual security may have a principal value or face amount greater than 10% of the account's total market value at the time of acquisition, except related to repurchase agreements fully collateralized by securities of the United States government and securities guaranteed by the United States government, either directly or indirectly.

Note 3. Fair Value of Financial Instruments

The fair value framework requires the categorization of assets and liabilities that are measured at fair value into one of three levels based on the assumptions (inputs) used in valuing the assets or liabilities. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1: Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are observable, other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in active markets.

Level 3: Inputs are unobservable, reflecting management's own assumptions about the inputs used in pricing the asset or liability.

The Fund uses the best available information in measuring fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Assets measured at fair value on a recurring basis at December 31, 2018 and 2017, are as follows:

	Quoted Prices in Active Markets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2018:			
U.S. Treasury issues	\$ 1,540,813	\$ -	\$ -
Negotiable certificates of deposit	8,053,750	-	-
	<u>\$ 9,594,563</u>	<u>\$ -</u>	<u>\$ -</u>
		Other	
	Quoted Prices in Active Markets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2017:			
U.S. Treasury issues	\$ 1,609,234	\$ -	\$ -
Negotiable certificates of deposit	4,819,750	-	-
	<u>\$ 6,428,984</u>	<u>\$ -</u>	<u>\$ -</u>

The fair value of U.S. Treasury issues and negotiable certificates of deposit is determined by reference to quoted market prices in an active market (Level 1). There were no transfers between levels in the year ended December 31, 2018 or 2017.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 4. Service Agreements

The Fund has an agreement with Insurance Benefits, Inc. (IBI) to provide program administration for the Fund. The agreement expires December 31, 2024. The base fee is adjusted on an annual basis by the greater of 3.5% or the annual change in the Consumer Price Index. Fees incurred under the agreement in 2018 and 2017 were \$477,148 and \$461,013, respectively.

The Fund has an agreement with Claims Associates, Inc. (CAI) to provide administrative, investigative and adjustment services for claims incurred. The agreement expires December 31, 2024. The base fee is adjusted on an annual basis by the greater of 3.5% or the annual change in the Consumer Price Index. The Fund has a deposit of \$300,000 with CAI that will be applied toward future claims payments and is recorded against the estimated liability for reported and unreported claims and claims adjustment expenses. The Fund also has other agreements with CAI or its affiliates for rehabilitation services and network utilization savings. Fees incurred under these agreements in 2018 and 2017 were \$1,214,072 and \$1,217,045, respectively.

Combined fees incurred to IBI and CAI under these agreements totaled \$1,691,220 and \$1,678,058 in 2018 and 2017, respectively, of which \$1,261,786 and \$1,263,146, respectively, is included in claims and claims adjustment expenses incurred, and the remainder is included in administrative and service fees.

The Fund has an agreement with Safety Benefits, Inc. to provide a loss control program for members. The agreement states that Safety Benefits, Inc. be compensated based on a fixed fee. The agreement expires December 31, 2019. The base fee is adjusted on an annual basis by the greater of 3.5% or the annual change in the Consumer Price Index. Fees incurred in 2018 and 2017 were \$342,224 and \$330,651, respectively, and are included in general and administrative expenses.

The Fund maintains accounts with BankWest under a custodial agreement. Fees incurred to BankWest during 2018 and 2017 were \$67,516 and \$65,674, respectively, which were included in net investment income.

Note 5. Reinsurance

The Fund utilizes reinsurance agreements to limit maximum loss and minimize exposures on larger risks. During both 2018 and 2017, individual claims are indemnified for amounts in excess of \$900,000, with a statutory limit per occurrence, except with respect to employers' liability, in which a sublimit of \$2,000,000 applies.

The Fund is liable for any obligations that the reinsurance companies are unable to meet under the reinsurance agreements. Reinsurance recoverables under reinsurance agreements on paid losses as of December 31, 2018 and 2017, were \$411,955 and \$322,699, respectively. Reinsurance recoverable amounts of \$8,830,198 and \$8,657,668 were deducted from the estimated liability for reported and unreported claims and claims adjustment expenses as of December 31, 2018 and 2017, respectively. During 2018 and 2017, claims expenses were reduced by \$619,845 and \$526,373, respectively, related to recoveries from reinsurance companies under contract.

The Fund has several structured settlements and annuities in claimants' names to fund future payments to those claimants. The Fund believes there is no material contingent liability related to these instruments. Accordingly, \$3,533,095 and \$3,417,200 are not reported as an asset or as a liability in the statements of net position as of December 31, 2018 and 2017, respectively.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 6. NLC Mutual Insurance Company

In prior years, the Fund had reinsurance coverage with NLC Mutual Insurance Company (NLC Mutual), and has since placed this coverage with other companies. Under the workers' compensation line of business of NLC Mutual, each member pool has a separate equity account (Capital). Contributed surplus requirements are determined as specified in NLC Mutual's bylaws.

Each NLC Mutual member's Capital account may be credited each year with the member's proportionate share of realized investment income earned by NLC Mutual during the prior fiscal year based on the total of all members' Capital accounts at NLC Mutual's discretion. Further, each member's Capital account may also be credited (or debited) from time to time based on NLC Mutual's financial condition, underwriting results, reserve adjustments and such other factors as NLC Mutual may reasonably consider in order to achieve fair and equitable results for NLC Mutual.

At the sole discretion of each NLC Mutual pool member, an election may be made to withdraw its Capital from any line of business reinsured by giving written notice to NLC Mutual. The effective date upon which such Capital may be withdrawn shall be determined by the withdrawing member based on a distribution election of no sooner than two years at 20% of Capital and no longer than 10 years at 100% of Capital. This distribution of Capital also requires the approval of NLC Mutual's Board of Directors and the State of Vermont Department of Banking, Insurance, Securities and Health Care Administration.

The Fund made no capital contributions to NLC Mutual in 2018 and 2017. As of December 31, 2018 and 2017, the Fund's Capital account balance was \$2,029,717 and \$1,960,132, respectively.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 7. Liability for Reported and Unreported Claims and Claims Adjustment Expenses

The Fund establishes liabilities for both reported and unreported covered events, which includes estimates of both future payments of claims and related claims adjustment expenses. The following is a summary of the changes in those aggregate liabilities for the years ended December 31, 2018, 2017 and 2016 (amounts in thousands):

	2018	2017	2016
Reported and unreported claims and claims adjustment expense liabilities at beginning of year	\$ 8,517	\$ 8,918	\$ 8,574
Incurred claims and claims adjustment expenses:			
Provision for insured events of the current year	6,914	5,487	5,723
Provision for insured events of prior years	(1,199)	(1,016)	(1,250)
Total incurred claims and claims adjustment expenses	5,715	4,471	4,473
Payments:			
Claims and claims adjustment expenses attributable to insured events of the current year	2,552	2,459	2,560
Claims and claims adjustment expenses attributable to insured events of prior years	2,113	2,430	1,507
Total payments	4,665	4,889	4,067
Less reinsurance recoverables at beginning of year	(323)	(306)	(368)
Plus reinsurance recoverables at end of year	412	323	306
Reported and unreported claims and claims adjustment expense liabilities at end of year	\$ 9,656	\$ 8,517	\$ 8,918

The 2018, 2017 and 2016 decreases in prior years' provisions of incurred claims and claims adjustment expenses resulted from positive loss development experience as more information became known and payments made, offset by accretion of discount on claims liabilities.

Note 8. Related-Party Transactions

SDML and the SDACC are the sponsoring organizations of the Fund. SDML performs management services for the Fund. Expenses incurred to SDML in 2018 and 2017 were \$53,638 and \$52,076, respectively, and were recognized in administrative and service fees. During 2018 and 2017, \$74,485 and \$68,577, respectively, of endorsement fees incurred to SDML were recognized in administrative and service fees. A member of the Fund's Board of Trustees is also the executive director of SDML.

During 2018 and 2017, \$49,657 and \$45,718, respectively, of endorsement fees incurred to the SDACC were recognized in administrative and service fees. A member of the Fund's Board of Trustees is also the executive director of the SDACC.

SDML Workers' Compensation Fund

Notes to Financial Statements

Note 9. Net Position

Any surplus monies for a fiscal year in excess of the amount necessary to fulfill all obligations of the Fund for that year may be refunded to the members at the discretion of the Board of Trustees. Return on equity credits were \$598,330 and \$546,040 during the years ended December 31, 2018 and 2017, respectively. Renewal and loss control credits were \$2,118,792 and \$2,025,552 during the years ended December 31, 2018 and 2017, respectively. Return on equity credits are reported as an expense of the Fund, and renewal and loss control credits are reported as a reduction of member contributions earned in the year in which the member renews. Discretionary dividends are reported as an expense of the Fund in the year declared.

The Fund's Board of Trustees has designated net position for a "deep reserve," which is not available for dividends to members. At December 31, 2018 and 2017, this amount was approximately \$9,572,000 and \$9,451,000, respectively.

Note 10. Contingencies

The Fund is a party to certain claims and legal actions arising during the ordinary course of business. It is management's opinion that these matters will not have a material adverse effect on the financial position or results of operations of the Fund.

SDML Workers' Compensation Fund

Required Supplementary Information—Schedule of Claims Development Information—Unaudited For the 10 Years Ended December 31, 2018 (Dollars in Thousands)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net earned member contributions and investment income:										
Earned	\$ 6,145	\$ 6,753	\$ 6,976	\$ 6,658	\$ 6,468	\$ 7,023	\$ 7,068	\$ 7,394	\$ 7,748	\$ 8,260
Ceded	399	436	400	474	541	590	593	607	629	653
Net earned	5,746	6,317	6,576	6,184	5,927	6,433	6,475	6,787	7,119	7,607
Unallocated expenses	831	887	929	926	968	1,013	1,034	1,027	1,063	1,089
Estimated claims and expenses, end of policy year:										
Incurred	4,820	6,315	6,649	5,450	6,859	5,685	6,020	6,237	6,013	7,534
Ceded	388	653	383	675	535	476	658	514	526	620
Net incurred	4,432	5,662	6,266	4,775	6,324	5,209	5,362	5,723	5,487	6,914
Net paid (cumulative) as of:										
End of policy year	1,555	2,202	1,976	2,003	3,090	2,346	2,484	2,560	2,459	2,552
One year later	2,402	3,157	3,689	2,795	4,114	3,134	3,491	3,605	3,358	
Two years later	2,638	3,696	4,473	2,911	4,801	3,326	3,971	4,285		
Three years later	3,440	3,863	4,579	2,965	4,978	3,612	4,016			
Four years later	3,491	4,063	4,621	3,055	5,279	3,639				
Five years later	3,232	4,101	4,643	3,110	5,346					
Six years later	3,239	4,152	4,647	3,109						
Seven years later	3,260	4,169	4,625							
Eight years later	3,262	4,185								
Nine years later	3,265									
Reestimated ceded claims and expenses	-	-	224	-	147	-	-	-	-	-
Reestimated net incurred claims and expenses:										
End of policy year	4,432	5,662	6,266	4,775	6,324	5,209	5,362	5,723	5,487	6,914
One year later	3,989	4,912	5,639	3,984	6,130	4,509	5,099	5,516	4,960	
Two years later	3,785	4,861	5,396	3,359	5,964	4,007	4,586	5,408		
Three years later	3,849	4,548	5,002	3,233	5,849	4,180	4,482			
Four years later	3,745	4,812	4,957	3,260	5,892	4,028				
Five years later	3,534	4,746	4,887	3,167	5,720					
Six years later	3,565	4,699	4,852	3,136						
Seven years later	3,422	4,506	4,815							
Eight years later	3,415	4,478								
Nine years later	3,389									
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	(1,043)	(1,184)	(1,451)	(1,639)	(604)	(1,181)	(880)	(315)	(527)	-

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards***

Independent Auditor's Report

Board of Trustees
SDML Workers' Compensation Fund

We have audited, 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, the financial statements of South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund) as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated June 27, 2019.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as Finding 2018-001, to be a significant deficiency.

Compliance and Other Matters

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

The Fund's Response to the Finding

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

Purpose of This Report

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

RSM US LLP

Sioux Falls, South Dakota
June 27, 2019

SDML Workers' Compensation Fund

Schedule of Findings and Responses Year Ended December 31, 2018

Finding 2018-001

Criteria or specific requirement: A system of internal controls requires a proper segregation of duties.

Condition: Several individuals have access to initiate automated clearing house (ACH) transactions and also have the ability to record transactions in the general ledger. The general ledger system utilized by the Fund is also unable to appropriately segregate duties, resulting in individuals with general ledger access having the ability to record journal entries across all transaction cycles with limited oversight of these activities.

Effect: A lack of segregation of duties could result in errors or irregularities occurring and not being detected on a timely basis.

Cause: Due to the small number of individuals involved in the accounting process, a lack of segregation of duties exists.

Recommendation: We recommend that the Fund perform an assessment of internal controls and either determine methods in which conflicting duties can be appropriately segregated or implement an appropriate review and approval process over significant transactions, including ACH transactions.

Views of responsible officials and management's planned corrective action: Management continues to review the duties assigned to accounting personnel and make changes to assignments, if necessary. This includes evaluating current procedures for online transactions and adding additional controls when the Fund is able to do so. The Fund will also continue to evaluate its general ledger software to determine if a change will allow for appropriate segregation of duties.

