NOTE 14: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pool

Public School Insurance Fund

The Public School Insurance Fund (the Fund) is a public entity risk pool reported within the enterprise funds. In accordance with Chapter 115C, Article 38, of the General Statutes, the purpose of the Fund is to insure the Local Education Agencies (LEAs), in order to safeguard the investment made in the public schools of North Carolina. The community colleges, which are component units, can also acquire insurance through the Fund as stated in G.S. 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to carry extended coverage against fire and lightning damage to the extent of not less than seventy-five percent (75%) of the current value for each insurable building. Additionally, the boards are to insure adequately the equipment and contents of said building. The Fund is financed by premiums collected from the LEAs and the community colleges and interest is earned on the Fund's cash balance. Each board has to give notice of its election to insure in the Fund at least 30 days prior to such insurance becoming effective and shall furnish to the State Board of Education a full and complete list of all outstanding fire insurance policies. While the said insurance policies remain in effect, the Fund shall act as coinsurer of the properties covered by such insurance. The Fund currently insures 98 out of 115 LEAs and 28 out of 58 community colleges.

Claim liabilities are based on estimates of the ultimate cost of losses that have been reported but not settled. There are no salvage claims anticipated since any salvage is adjusted in the claim settlement. There are no subrogation claims pending. Since claims are reviewed by adjusters and the actual loss projection is computed in a short time after the claim is reported, the claim adjustment expense associated with the unpaid claim liability will be reflected in the current period. The Fund does consider investment income in determining if a premium deficiency exists.

The only acquisition costs are related to proposal costs and inspection costs for new insurance. Since the Fund can only insure the LEAs and the community colleges, new contracts are immaterial. Since existing contracts are renewed once a year, the Fund's costs are for policy maintenance. Therefore, acquisition costs do not need to be amortized.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year	
	2006	2005
Unpaid claims at beginning of year ...	$ 1,229	$ 3,947
Incurred claims:		
Provision for insured events of the current year	3,273	3,239
Increases (decreases) in provision for insured events of prior years	(177)	(417)
Total incurred claims	3,096	2,822
Payments:		
Claims attributable to insured events of the current year	2,326	2,552
Claims attributable to insured events of the prior years	1,203	2,988
Total payments	3,529	5,540
Total unpaid claims at end of the year	$ 796	$ 1,229

With the collection of premiums from the insured educational units, payment of valid claims becomes the responsibility of the Fund. All claims greater than $10 million per occurrence are covered by reinsurance policies. Maximum recoverable from reinsurance for any one catastrophic event is $45.5 million per occurrence. Annual aggregate limits of $15 million apply separately with respect to flood and earthquake. Coverage applies to all "all risk" perils. Boiler and machinery coverage is provided under separate contract underwritten by the Fund. Incurred losses are reduced by estimated amounts recoverable under the Fund's reinsurance policies. Currently, there are no claims for reinsurance.

B. Employee Benefit Plans

1. State Health Plan

In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State established the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan, referred to as the State Health Plan (the Plan). The Plan provides comprehensive major medical care benefits for employees and retirees of the State and its participating component units, as well as their qualified dependents on a contributory basis. This care is also extended to employees and retirees of the Local Education Agencies (LEAs), and other employing units allowed by statute, which are not part of the State's reporting entity. Coverage is self-funded by contributions to the Plan, which is reported as a pension and other employee benefit trust fund. Contributions for employee

and retiree coverage are made by the State, its participating component units, LEAs, and other qualified employing units. Contributions for dependent coverage are made by employees and retirees. As described in Note 13, coverage is also extended to certain individuals as an other postemployment benefit. The Plan has contracted with third parties to process claims.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and co-payment requirements. The Plan disallows claims in excess of a lifetime maximum of $5 million.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the Plan's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 166,672	$ 1,728,605	$ (1,663,314)	$ 231,963
2005-06	231,963	1,698,407	(1,759,906)	170,464

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, a pension and other employee benefit trust fund, to all members of the Teachers' and State Employees' Retirement System who have completed at least 12 consecutive months of membership in the System. Membership includes employees of the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of $25,000 and to a maximum of $50,000.

For the period July 1, 2005 to June 30, 2006, death benefits were funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs contributed .16% of active employees' salaries to fund the Death Benefit Plan for the period July 2005 to June 2006.

These benefits are established by Chapter 135, Section 5(l), of the General Statutes and may be amended only by the North Carolina General Assembly. Claims liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported).

Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 1,909	$ 31,222	$ (30,865)	$ 2,266
2005-06	2,266	26,412	(25,931)	2,747

3. Disability Income Plan of North Carolina

Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a pension and other employee benefit trust fund, to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. As discussed in Note 13, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

Claim liabilities for long-term disability benefits are actuarially estimated using the one-year term cost method. These liabilities represent the present value of future claim payments obligated to members who have become disabled. The claim liabilities are separated into the following two classifications: (1) approved claim liabilities are for long-term disabilities that have occurred, have been approved, and are in long-term payment status; and (2) incurred but not reported (IBNR) liabilities are for disabilities that have occurred but are not in payment status. The IBNR liabilities are estimated based on the historical claims experience of DIPNC.

Significant actuarial assumptions used to estimate claim liabilities are presented in Note 13. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 281,133	$ 63,653	$ (53,591)	$ 291,195
2005-06	291,195	87,884	(59,836)	319,243

C. Other Risk Management and Insurance Activities

1. Automobile, Fire and Other Property Losses

The State is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle, which includes vehicles held by the State's participating component units. The State is self-insured for the first $500,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than $500,000. The liability limits for losses incurring in-state are $500,000 per claimant and $5 million per occurrence. For losses incurring out-of-state, the limits are $1 million per claimant and $5 million per occurrence. Covered losses include those that occur with vehicles that are not on a stationary track or rail, and federal vehicles when the Governor calls out the National Guard.

Agencies of the State and participating component units using state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred. The private insurer processes all claims and sets up a reserve for amounts expected to be paid for claims. Claims are paid by the private insurer after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

The State Property Fire Insurance Fund (the Fund), an internal service fund of the State, was created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. The Fund does not charge premiums for fire insurance for operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Agencies of the State can purchase extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents through the Fund. For those that elect to receive any of this other coverage, the Fund charges premiums discounted from industry manual rates. The Fund insures losses up to $2.5 million per occurrence. All losses covered by the Fund are subject to a $500 per occurrence deductible except for theft, which carries a $1,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the Fund. If aggregate uninsured losses sustained by the Fund, in excess of $50,000 per loss, other than flood and earthquake losses and wind losses by named storms, reach $5 million in any one annual period, the Fund's deductible for the remainder of the annual period is $100,000 per occurrence. Settled claims have not exceeded coverage in any of the past three fiscal years.

Claims of $10,000 or higher are paid when the Council of State approves the request for payment. Claims less than $10,000 are paid without Council of State approval. Claims costs are recognized when they are approved by the Council of State and are outstanding for payment; when known estimates of losses are waiting to be submitted to the Council of State for approval; or when a loss occurs and can be reasonably estimated. Claims payable at June 30, 2006 are disclosed on the balance sheet as claims payable. Changes in the balances of claims liabilities for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 1,227	$ 1,451	$ (997)	$ 1,681
2005-06	1,681	1,242	(1,863)	1,060

2. Medical Malpractice Protection

a. Professional Liability Insurance for State Medical Personnel

All agencies of the State and participating component units are insured for tort claims up to $500,000 under the authority of the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. Organizations within the reporting entity carry excess commercial liability insurance to supplement the coverage provided by the State Tort Claims Act; however, claims involving medical malpractice are generally excluded from this coverage. The University of North Carolina at Chapel Hill Medical School (UNC-CH Medical School) and UNC Hospitals participate in the Liability Insurance Trust Fund, which is described in detail below. All other universities purchase commercial liability insurance. Chapter 237, Section 11.33, of the 1999 Session Laws of North Carolina authorized the Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction to provide medical liability coverage on behalf of employees licensed to practice medicine or dentistry; all licensed physicians who are faculty members of the University of North Carolina who work on contract for the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services for incidents that occur in Division programs; and on behalf of medical residents from the University of North Carolina who are in training at institutions operated by the Department of Health and Human Services. The extent of coverage is a maximum of $1 million for each individual incident and does not affect current coverage under the State Tort Claims Act. The Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction purchase commercial professional liability insurance for their medical staff. Settled claims have not exceeded coverage in any of the past three fiscal years.

Insurance coverage varies depending upon the amount of coverage and the type of policy. Typically the amount of primary coverage for medical liability is $1 million per individual, claim, or incidence, and $3 million total or aggregate. Many departments and institutions maintain excess policies to provide additional coverage above that provided by the primary policy for medical liability. The policies are written on a claims made or occurrence basis, with the majority of the policies being claims made. The claims liabilities are not measurable.

b. Self-Insurance through the Liability Insurance Trust Fund

The Liability Insurance Trust Fund (Trust Fund) was created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978, to provide medical malpractice protection for program participants and individual health care practitioners working as employees, agents, or officers of the program participants. The program participants are the University of North Carolina Hospitals at Chapel Hill and the University of North Carolina at Chapel Hill Physicians and Associates, both of whom are a part of the University of North Carolina system, which is a component unit of the reporting entity. Coverage is self-funded by contributions from participants and investment income. Contributions are based on the actuarially determined funding level for a given plan year.

For the period July 1, 2005 through June 30, 2006, the Trust fund provided coverage on an occurrence basis of $3 million per individual and $7 million in the aggregate per claim. At May 1, 2005 through June 30, 2006, the Trust Fund provided coverage on an occurrence basis of $7 million per individual for each and every claim, self-insured through the Trust Fund. Effective July 1, 2005 through June 30, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer. Reinsurance coverage under this policy carries a $10 million aggregate limit in excess of a self-insured aggregate of $33 million subject to a $7 million per occurrence limit (sub-limit of $3 million per individual) with a $200,000 continuing underlying amount per claim. For losses occurring during the period May 1, 2004 through June 30, 2005, the Trust Fund retained 100% of the liability.

The Trust Fund purchased a primary policy for dental residents on a claims made basis with $1 million per occurrence and $3 million annual aggregate limits of coverage. In the event the Trust Fund has insufficient funds to pay existing and future claims, it has the authority to borrow necessary amounts up to $30 million. Any such borrowing would be repaid from the assets and revenues of program participants. No borrowings have been made under this authority to date.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of all losses and loss adjustment expenses, including losses and loss adjustment expenses incurred but not yet reported, which are unpaid at the balance sheet date. The claims liabilities of $48.178 million and $52.230 million are the present values of the aggregate actuarially determined claims liabilities of $48.768 million and $55.296 million, discounted at 3% at June 30, 2005 and 5% at June 30, 2006, respectively. These estimates are reviewed annually, and as adjustments become necessary, such adjustments are reflected in current operations. Claims against participants are paid from the corpus of the Trust Fund. Changes in the Trust Fund's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 38,085	$ 18,120	$ (8,027)	$ 48,178
2005-06	48,178	10,453	(6,401)	52,230

3. Public Officers' and Employees' Liability Insurance

In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units except for doctors and dentists. The policy provides $5 million excess insurance over the $500,000 statutory limit payable for any one claim under the State Tort Claims Act. The first $150,000 of an award against a state agency is the responsibility of the state agency's general fund budget code or up to $500,000 if a non-general fund budget code. For general fund budget codes, any award greater than $150,000 but less than $500,000 is funded by proportionate shares of estimated lapse salaries from all agencies general fund budget codes. Since State agencies and component units are responsible for funding any tort claims of $500,000 or less from their budget and/or lapse salaries, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

4. Employee Dishonesty and Computer Fraud

Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State and its component units with a limit of $5 million per occurrence, subject to a $50,000 deductible and a 10% participation in each loss above the deductible. This coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance. Agencies of the State and its component units are charged premiums by the private insurance company. A small number of State agencies and component units of the State require faithful performance coverage in addition to employee dishonesty coverage. In these instances, separate policies have been purchased. The amounts of coverage and the deductibles vary among these separate policies. Settled claims have not exceeded coverage in any of the past three fiscal years.

5. Statewide Workers' Compensation Program

The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job. All employees of the State and its component units are included in the Program. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. Payments of all medical benefits are subject to approval based on a fee schedule established by the North Carolina Industrial Commission (NCIC). Loss of wages and disability benefits are payable based on 66 2/3% of an employee's average weekly salary subject to a statutory compensation rate minimum and maximum established annually by the NCIC. Death benefits are payable for 400 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 400 weeks.

The responsibility for claiming compensation is on the injured employee. If the injured employee or his representative does not notify the employer within 30 days from the date of injury, the employer can refuse compensation. A claim must be filed with the NCIC by either the employee or the employer within two years from the date of knowledge thereof; otherwise the claim is barred by law and no further compensation is allowable. When an employee is injured, the employer's primary responsibility is to arrange for and provide the necessary treatment for any work-related injury. The employer tries to provide the best possible medical care for injured employees to help them reach maximum medical improvement and return to work as soon as possible.

The State and its component units are self-insured for workers' compensation. A third-party administrator handles workers' compensation claims except for the Department of Transportation. State agencies and participating component units contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

Each state agency and participating component unit is responsible for paying claims out of its individual budget. Budgets for workers' compensation for most State agencies and participating component units are based on the prior year's loss experience. Since the related liability is not measurable, claim costs are recognized when paid. The Department of Transportation is the only state agency that sets up a reserve for claims. For the year ended June 30, 2006, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	$ 33,000
University of North Carolina System	2,283
All other component units	4
Total	$ 35,287

6. Workers' Compensation Fund

The Workers' Compensation Fund (the Fund) is an insurance enterprise reported within the enterprise funds. The Fund is created in the Department of Insurance (the Department) and is administered by the State Fire and Rescue Commission (the Commission) through a service contract with a third-party administrator. In accordance with Chapter 58, Article 87, of the General Statutes, the purpose of the Program is to provide workers' compensation benefits to members of "eligible units," which consist of volunteer fire departments or volunteer rescue/EMS units that are not part of a unit of local government and are exempt from State income tax under G.S. 105-130.11. These eligible units are not part of the reporting entity. Benefits are payable for compensable injuries or deaths which occurred on or after July 1, 1996. The Fund is financed by appropriations made to the Department for this purpose and by per capita fixed dollar amounts for each member of a participating eligible unit's roster. The per capita fixed dollar amount is set annually by the Commission and is paid by the eligible units to the Commission on or before July 1 of each year for credit to the Fund. If payment is not received by July 1, the eligible unit shall not receive workers' compensation coverage for that fiscal year. The appropriation for the fiscal year ended June 30, 2006 was $2 million. As of June 30, 2006, the Fund consisted of 1,239 eligible units representing approximately 43,027 members.

The liability for unpaid claims is based on an actuarial determination and represents a reasonable estimate of the ultimate cost of open claims and claim settlement expenses that are unpaid as of the fiscal year end, including incurred but not reported losses. The liability for unpaid claims is continually reviewed, and as adjustments become necessary such adjustments are included in current operations. The Program considers anticipated investment income in determining if a premium deficiency exists. The Program recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 2006, there was no reduction for subrogation.

Acquisition costs consist of commission payments to independent insurance agents for marketing, promotional and administrative assistance with policy maintenance to eligible units. As coverage is renewed annually, acquisition costs are not amortized.

The Program maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Program's retention of $500,000 per occurrence and a $1.5 million limit for employer's liability above the Program's retention of $500,000 per occurrence. Incurred losses are reduced by estimated amounts recoverable under the Program's excess of loss and aggregate reinsurance policies. As of June 30, 2006, there are claims recoverable from reinsurers in the amount of $816,219.67.

The following schedule shows the changes in the reported liability for the past two fiscal years (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 9,786	$ 5,594	$ (5,266)	$ 10,114
2005-06	10,114	6,715	(5,656)	11,173

7. Health Insurance Program for Children

The Health Insurance Program for Children (the Program) is an insurance enterprise reported within the general fund. The Program was created by Chapter 108A, Article 2, Part 8, of the General Statutes to provide comprehensive health insurance coverage to uninsured low-income children who are residents of this State, including coverage for dental, hearing, and vision services and supplies.

Coverage is provided from federal funds received, State funds appropriated, and other nonappropriated funds made available for this purpose. All appropriations, allocations, premium receipts, or any other receipts, including earnings on investments, occurring or arising in connection with acute medical care benefits provided under the Program are deposited into the Child Health Insurance Fund (the Fund). Disbursements from the Fund include any and all amounts required to pay the benefits and administrative costs of the Program. For the fiscal year ended June 30, 2006, $68.16 million was appropriated from the General Fund to the North Carolina Department of Health and Human Services (DHHS) to be used for the Program.

The Program is administered by DHHS. Eligible children may be enrolled by the Division of Social Services based on the availability of funds. The North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (The Plan) is responsible for the administration and processing of claims for benefits under the Program, as provided under Chapter 135, Article 3, Part 5 of the General Statutes. The Plan's self-insured indemnity program shall not incur any financial obligations for the program in excess of the amount of funds that the Plan's self-insured indemnity program receives for the program.

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Annual enrollment fees, co-payments, or other cost-sharing charges are determined by family income. However, there are no enrollment fees, deductibles, co-payments, or other cost-sharing charges for families covered under the Program whose family income is at or below 150% of the federal poverty level. A family's total annual aggregate cost-sharing charges shall not exceed five percent of the family's income for the year involved. The program had an enrollment of 109,466 children as of June 30, 2006, and an average enrollment of 118,965 children insured during the year.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). The following schedule shows the changes in the claims liability for the Program's past two years of operation (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2004-05	$ 22,334	$ 250,719	$ (240,700)	$ 32,353
2005-06	32,353	223,718	(235,070)	21,001