

NOTES TO THE FINANCIAL STATEMENTS**NOTE 15: 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 property investments 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 General Statute 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to insure their buildings and contents on a replacement cost basis, as suggested by the Fund. 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 Fund a detailed list of all school buildings, contents and other insurable school property. While policies remain in effect, the Fund shall act as insurer of the properties covered by such insurance. The Fund currently insures 88 out of 116 LEAs and 31 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 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 only acquisition costs are related to proposal costs and inspection costs for insured members. 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	
	2014	2013
Unpaid claims at beginning of year	\$ 7,960	\$ 23,895
Incurred claims:		
Provision for insured events		
of the current year	8,585	6,386
Increases (decreases) in provision		
for insured events of prior years	(6,453)	(5,471)
Total incurred claims	<u>2,132</u>	<u>915</u>
Payments:		
Claims attributable to insured		
events of the current year	1,845	1,975
Claims attributable to insured		
events of the prior years	<u>1,086</u>	<u>14,875</u>
Total payments	<u>2,931</u>	<u>16,850</u>
Total unpaid claims at end		
of the year	<u>\$ 7,161</u>	<u>\$ 7,960</u>

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 contracts. Maximum recoverable from reinsurance for any one catastrophic event is \$45.5 million per occurrence. Losses in excess of the reinsurance limit would be paid by the Fund from long-term investments, subject to the maximum amount of available funds. Annual aggregate limits of \$15 million apply separately with respect to flood and earthquake. Coverage applies to "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.

NOTES TO THE FINANCIAL STATEMENTS**B. Employee Benefit Plans****1. State Health Plan**

In accordance with Chapter 135, Article 3B, Part 1, of the General Statutes, the State established the North Carolina State Health Plan for Teachers and State Employees, referred to as the State Health Plan (the Plan). The Plan provides comprehensive healthcare benefits for employees and retirees of the State and its participating component units, as well as their qualified dependents on a contributory basis. These benefits are 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.

The Plan is reported as a major component unit. Coverage for active employees, non-Medicare retirees, and some Medicare retirees is self funded. Medicare retirees also have the option of selecting a fully-insured Medicare Advantage/Prescription Drug Plan (MA-PDP). Contributions for employee and retiree coverage are made by the State, its participating component units, LEAs, and other qualified employing units. Some of the plans also require an employee or retiree contribution, depending on the plan selected or the employee's or retiree's willingness to participate in wellness activities that reduce or eliminate employee contributions. Contributions for dependent coverage are made by employees and retirees. As described in Note 14, 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 allowed amounts for PPO plan members. Claims are subject to specified annual deductible and co-payment requirements. The Plan provides an unlimited lifetime benefit for the PPO plans. The authority for the PPO plans is provided in General Statute 135-48.2.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Claim liabilities do not include nonincremental claims adjustment expenses. 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
2012-13	\$ 244,060	\$ 2,491,957	\$ (2,490,686)	\$ 245,331
2013-14	245,331	2,606,997	(2,619,652)	232,676

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. Employees of Local Education Agencies (LEAs) and miscellaneous educational units which are not part of the reporting entity are also included. 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 12 month's salary in a row during the 24 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, 2013 to June 30, 2014, 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, participating proprietary component units, LEAs and other miscellaneous educational units contributed 0.16% of covered payroll (as defined in Note 14) to fund the Death Benefit Plan for the period July 2013 to June 2014.

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These benefits are established by General Statute 135-5(1) 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
2012-13	\$ 3,533	\$ 45,620	\$ (45,671)	\$ 3,482
2013-14	3,482	44,612	(44,134)	3,960

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 the University Employees' Optional Retirement Program. Employees of Local Education Agencies (LEAs) and miscellaneous educational units which are not part of the reporting entity are also included. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability. The 60 day waiting period is determined from the last actual day of service, the day of the disabling event if the disabling event occurred on a day other than a normal workday, or the day succeeding at least 365 calendar days after service as a State teacher or State employee, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. The Board of Trustees may extend the short-term disability benefits of a beneficiary beyond the benefit period of 365 days for an additional period of not more than 365 days; provided the Medical Board determines that the beneficiary's disability is temporary and likely to end within the extended period of short-term disability benefits. During the extended period of short-term disability benefits, payment of benefits shall be made by the Plan directly to the beneficiary. As discussed in Note 14, 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.

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 \$1 million of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$1 million up to \$10 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. The Fund insures losses up to \$2.5 million per occurrence. All losses covered by the Fund are subject to a \$5,000 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 retention 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.

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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. 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
2012-13	\$ 1,553	\$ 372	\$ (806)	\$ 1,119
2013-14	1,119	1,238	(1,017)	1,340

2. Medical Malpractice Protection**a. Professional Liability Insurance for State Medical Personnel**

Agencies of the State and participating component units are insured under the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. This act allows partial waiver of sovereign immunity up to \$1 million that the State may pay cumulatively to all claimants on account of injury and damage to any one person arising out of a single occurrence. The State has purchased commercial liability insurance for state employees which is excess over recovery from the Tort Claims Act and Defense of State Employees Act; however, claims involving medical malpractice are generally excluded from this coverage.

The University of North Carolina at Chapel Hill Medical School and UNC Hospitals participate in the Liability Insurance Trust Fund, which is described in detail below. East Carolina University (ECU) provides medical malpractice insurance for the Brody School of Medicine faculty physicians and independently licensed allied health providers. There is a shared blanket policy for all other employees of the ECU Physicians. The medical malpractice insurance is with a private insurance company with coverage of \$3 million per occurrence, \$5 million annual aggregate, and a \$200,000 deductible; as well as an excess policy in the amount of \$10 million. All other universities purchase medical professional 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 Public Safety 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 Public Safety 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. Some departments and institutions have purchased higher limits 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) is an unincorporated entity created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978. The Trust Fund is a self-insurance program established to provide professional medical malpractice liability covering the University of North Carolina Hospitals at Chapel Hill (the Hospitals) and the University of North Carolina at Chapel Hill Faculty Physicians (UNCFP). The Trust Fund provides coverage for program participants and individual health care practitioners working as employees, agents, or officers of program participants. The Trust Fund is exempt from federal and state income taxes, and is not subject to regulation by the North Carolina Department of Insurance. 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 periods ending June 30, 2013 and June 30, 2014, the Trust Fund provided coverage on an occurrence basis of \$3 million per individual and \$7 million in the aggregate per claim. Excess reinsurance coverage was not purchased for the policy years ending June 30, 2013 and June 30, 2014, as the Trust Fund chose to retain 100% of the liability. In lieu of reinsurance, the participants contributed \$10 million in the aggregate into the Reimbursement Fund during previous fiscal years for future losses.

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For the fiscal year ending June 30, 2014, the Trust Fund purchased a direct insurance policy to cover the first \$1 million per occurrence and \$3 million in the aggregate for dental residents. 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 council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

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 \$44.282 million and \$41.842 million are the present values of the aggregate actuarially determined claims liabilities of \$40.656 million and \$49.48 million, discounted at 0.5% at June 30, 2013 and 0.5% at June 30, 2014.

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
2012-13	\$ 48,885	\$ 5,482	\$ (10,085)	\$ 44,282
2013-14	44,282	1,588	(4,028)	41,842

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 \$10 million excess insurance over the \$1 million 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 \$1 million if a Non-General Fund budget code. For General Fund budget codes, any award greater than \$150,000 but less than \$1 million 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 \$1 million 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 10% participation in each loss and a \$75,000 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 Statewide Workers' Compensation Program (the Program) was created by Chapter 97, Article 1; Chapter 115C, Article 23; and Chapter 115D, Article 2 of the General Statutes to provide benefits to workers injured on the job. The program includes all employees of the State, universities and certain other component units. The program also includes community college employees and employees of Local Education Agencies (LEAs) whose salaries are paid with State funds. Although the LEAs are not part of the State reporting entity, the State is responsible for the workers' compensation liability of the state-funded LEA employees. Similarly, although community colleges are component units of the State, the primary government is responsible for the workers' compensation liability of state-funded college employees.

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

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maximum established annually by the NCIC. Death benefits are payable for 500 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 500 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. State agencies and participating component units contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. This fund is reported as an internal service fund. 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. The Department of Public Instruction administers the Program for the State funded LEA employees through the same third party administrator.

Each state agency and participating component unit is billed for claims and an administrative fee paid to the third party administrator. Budgets for workers' compensation for most state agencies and participating component units are based on the prior year's loss experience. The workers' compensation liability is recognized when it is probable and reasonably estimated. This liability is presented as a component of the Governmental Activities Long-Term Liabilities.

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
2012-13	\$ 136,732	\$ 73,227	\$ (59,708)	\$ 150,251
2013-14	150,251	90,927	(63,464)	177,714

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 Workers' Compensation Fund 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 General Statute 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 transfers from General Fund 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. As of June 30, 2014, the Fund consisted of 1,120 eligible units representing approximately 42,787 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. Claim liabilities do not include nonincremental claims adjustment expenses. The Fund considers anticipated investment income in determining if a premium deficiency exists. The Fund recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 2014, 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 Fund maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Fund's retention of \$500,000 per occurrence and a \$1.5 million limit for employer's liability above the Fund's retention of \$500,000 per occurrence. Incurred losses are reduced by estimated amounts recoverable under the Fund's excess of

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loss and aggregate reinsurance policies. As of June 30, 2014, there are claims recoverable from reinsurers in the amount of \$100 thousand.

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
2012-13	\$ 18,991	\$ 10,665	\$ (11,075)	\$ 18,581
2013-14	18,581	10,523	(7,554)	21,550