

Ohio Government Risk Management Plan

Financial Statements

for the years ended December 31, 2002 and 2001

Ohio Government Risk Management Plan

Table of Contents December 31, 2002 and 2001

<u>Report</u>	<u>Page</u>
Report of Independent Accountants	1
Balance Sheets	2
Statements of Revenues, Expenses and Changes in Members' Equity	3
Statements of Cash Flows	4
Notes to the Financial Statements	5-10
Report of Independent Accountants on Supplemental Information	11
Required Supplemental Information	12

Report of Independent Accountants

To the Board of Directors of
the Ohio Government Risk Management Plan:

We have audited the accompanying balance sheets of the Ohio Government Risk Management Plan (the "Plan") as of December 31, 2002 and 2001, and the related statements of revenues, expenses and changes in members' equity and cash flows, for the years then ended. These financial statements are the responsibility of the Plan's management. 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, which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Ohio Government Risk Management Plan as of December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP

March 31, 2003

Ohio Government Risk Management Plan

Balance Sheets December 31, 2002 and 2001

	2002	2001
Assets		
Cash and cash equivalents	\$ 909,064	\$ 1,170,026
Short-term investments, at fair value	7,415	442,038
Bonds, at fair value	2,561,359	2,901,813
Equity securities, at fair value	575,803	853,218
Premiums receivable	1,178,831	1,069,444
Prepaid reinsurance	108,333	-
Reinsurance recoverable	215,560	416,115
Accrued interest receivable	28,227	31,450
	<u>28,227</u>	<u>31,450</u>
Total assets	<u>\$ 5,584,592</u>	<u>\$ 6,884,104</u>
Liabilities and Members' equity:		
Liabilities		
Loss and loss adjustment expense reserves	\$ 754,766	\$ 2,122,787
Unearned premiums	397,067	206,020
Accrued liabilities and fees	144,943	257,893
Reinsurance payable	1,145,017	1,391,304
	<u>1,145,017</u>	<u>1,391,304</u>
Total liabilities	<u>2,441,793</u>	<u>3,978,004</u>
Members' equity		
Accumulated surplus	<u>3,142,799</u>	<u>2,906,100</u>
Total members' equity	<u>3,142,799</u>	<u>2,906,100</u>
Total liabilities and members' equity	<u>\$ 5,584,592</u>	<u>\$ 6,884,104</u>

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

Ohio Government Risk Management Plan

Statements of Revenues, Expenses and Changes in Members' Equity For the years ended December 31, 2002 and 2001

	2002	2001
Revenues		
Premiums written	\$ 13,671,363	\$ 12,253,510
Reinsurance premiums ceded	<u>(10,961,225)</u>	<u>(8,645,401)</u>
Net premiums written	2,710,138	3,608,109
Change in unearned premiums	<u>(191,047)</u>	<u>(23,432)</u>
Net premiums earned	2,519,091	3,584,677
Membership fees	152,084	150,750
Net investment income (loss)	(189,148)	83,626
Other income	<u>12,000</u>	<u>-</u>
Total revenues	<u>2,494,027</u>	<u>3,819,053</u>
Expenses		
Loss and loss adjustment expense	(1,325,581)	2,115,000
Management fees	1,851,623	1,924,158
Commission expense	1,399,087	1,248,684
Newsletter publishing and postage	6,040	10,675
Directors' travel and meetings	46,771	55,118
Risk management committee meetings and seminars	6,096	6,484
Property appraisals	97,032	325,000
Professional fees	135,621	139,190
Plan marketing	6,964	60,899
Directors' and officers' coverage	26,250	17,500
Other	<u>7,425</u>	<u>19,101</u>
Total expenses	2,257,328	5,921,809
Excess (deficiency) of revenues over expenses	236,699	(2,102,756)
Members' equity		
Beginning of year	<u>2,906,100</u>	<u>5,008,856</u>
End of year	<u>\$ 3,142,799</u>	<u>\$ 2,906,100</u>

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

Ohio Government Risk Management Plan

Statements of Cash Flows

For the years ended December 31, 2002 and 2001

	2002	2001
Cash flows from operating activities		
Excess (deficiency) of revenues over expenses	\$ 236,699	\$ (2,102,756)
Net change in the fair value of investments	297,370	126,975
Changes in operating assets and liabilities		
Premiums receivable	(109,387)	(208,442)
Prepaid reinsurance	(108,333)	-
Reinsurance recoverable	200,554	(310,030)
Accrued interest receivable	3,223	8,923
Loss and loss adjustment expense reserves	(1,368,021)	2,114,590
Unearned premiums	191,047	23,432
Accrued liabilities and fees	(112,950)	134,755
Reinsurance payable	<u>(246,287)</u>	<u>314,188</u>
Net cash provided by (used in) operating activities	<u>(1,016,085)</u>	<u>101,635</u>
Cash flows from investing activities		
Change in short term investments	435,733	(129,714)
Purchases:		
Bonds	(4,058,275)	(1,979,333)
Sales:		
Bonds	1,052,665	277,678
Maturities:		
Bonds	<u>3,325,000</u>	<u>1,664,504</u>
Net cash provided by (used in) investing activities	<u>755,123</u>	<u>(166,865)</u>
Net decrease in cash and cash equivalents	(260,962)	(65,230)
Cash and cash equivalents, beginning of year	<u>1,170,026</u>	<u>1,235,256</u>
Cash and cash equivalents, end of year	<u>\$ 909,064</u>	<u>\$ 1,170,026</u>

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

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

1. Description of the Organization

The following descriptions provide only general information. Reference should be made to the Plan Agreement for a more complete description.

The Ohio Government Risk Management Plan (the "Plan") was organized in June of 1988 as authorized by Section 2744.081 of the Ohio Revised Code. The Plan is an unincorporated non-profit association of its members and an instrumentality for each member for the sole purpose of enabling members of the Plan to provide for a formalized, jointly administered self-insurance program to maintain adequate self-insurance protection, risk management programs and other administrative services. Pursuant to Section 2744.081 of the Ohio Revised Code, the Plan is deemed a separate legal entity for the public purpose of enabling its members to obtain self-insurance through a jointly administered self-insurance fund. Members of the Plan are relatively small political subdivisions such as townships, villages, small cities and others in the State of Ohio which are eligible to participate under applicable statute, ruling or law subject to certain underwriting standards as deemed appropriate by the Plan and its administrator.

The Plan was established to provide property, liability, errors and omissions, law enforcement, automobile, excess liability, crime, surety and bond, inland marine and other coverages to its members sold through ten appointed independent agents in the State of Ohio. Coverage programs are developed specific to each member's risk management needs and the related premiums for coverage are determined through the application of uniform underwriting criteria addressing the member's exposure to loss. The Plan has agreed to pay judgments, settlements and other expenses resulting from claims arising related to the coverage provided in excess of the member's deductible.

The Plan has chosen to adopt the forms and endorsements of conventional insurance coverage and to reinsure these coverages no less than 95% within certain aggregate limits, rather than utilize a risk pool of member funds to pay individual and collective losses up to a given retention, and then have excess reinsurance coverage above the retention amount. Therefore, the individual members are only responsible for their self-retention (deductible) amounts that vary from member to member. See footnote 3 for further explanation.

The members pay an annual membership fee that is based on a percentage of premiums written for the year, which is earned when billed and not subject to refund due to policy cancellation. These fees are charged to cover professional fees, directors' travel and meeting expenses and other administrative expenses. Membership fees were \$152,084 and \$150,750 for the years ended December 31, 2002 and 2001, respectively.

The Plan had 625 and 667 members as of December 31, 2002 and 2001, respectively.

The Plan has an agreement with Hylant Administrative Services, Inc. ("HAS") to provide underwriting, claims management, risk management, accounting and system support services for the Plan. HAS also provides reinsurance brokerage services to the Plan. All of these services are paid for by the Plan. See Note 2 for further discussion.

The Plan is comprised exclusively of Ohio political subdivisions. Although its exposure is concentrated to a single geographical area, such exposure is reduced by the practice of reinsuring no less than 95% of coverage provided, with the exception of its casualty finite reinsurance layer. See footnote 3 for further discussion.

Effective September 1, 2002, the Plan began retaining 5% of the premium and losses on the first \$500,000 casualty treaty and 5% of the first \$1,000,000 property treaty.

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

The Plan has also elected to participate in a loss corridor in its first \$500,000 of casualty reinsurance. The corridor includes losses paid between 55% and 65% of premiums earned under this treaty. If the Plan's paid loss ratio reaches 55%, the Plan would pay all the losses incurred related to this treaty up to the next 10% of premiums earned. Reinsurance coverage would resume after a paid loss ratio of 65% is exceeded.

2. Summary of Significant Accounting Policies

Accounting Policies

The accounting policies of the Plan conform to generally accept accounting principles ("GAAP") as prescribed by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants.

Estimates

The preparation of financial statements in conformity with GAAP requires the Plan to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Governmental Accounting Standards Board ("GASB") Statement No. 3, "Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements," requires the Plan to categorize cash and cash equivalents held by the Plan to give an indication of the level of risk assumed by the Plan at year end. Category 1 includes cash and cash equivalents that are insured or collateralized with securities held by the Plan or by its agent in the Plan's name. Category 2 includes cash and cash equivalents that are collateralized with securities held by the pledging financial institutions trust department or agent. Category 3 includes cash and cash equivalents that are uncollateralized.

Cash and cash equivalents represents a bank account balance of \$1,140,181 and \$1,563,891 as of December 31, 2002 and 2001, respectively. The bank account balance is Category 1 to the extent it is insured up to \$100,000 by the Federal Deposit Insurance Corporation (the "FDIC"). The remainder of the bank account balance is Category 3.

Investments

The Plan has adopted GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". As required by GASB Statement No. 31, the Plan has recognized its short-term investments, bonds, and equity securities at fair value with all related investment income, including the change in the fair value of investments and realized gains and losses, reflected in the Plan's revenues in the Statement of Revenues, Expenses and Changes in Members' Equity.

Short-term investments consist of commercial paper and U.S. Treasury Bills and money market funds with maturities less than one year. The Plan intends to hold all short-term securities to maturity. Bonds represent U.S. Treasury Notes and other obligations of the U.S. Federal Government and its agencies with maturities greater than one year. Bonds are held for indefinite periods of time and may be sold in response to changes in interest rates, liquidity needs or other market conditions. Equity securities consist solely of shares held in the Fifth-Third Quality Growth

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

Fund. This fund seeks to provide long-term capital appreciation by investing primarily in the stocks of well-established growth companies in the United States.

Investment transactions are recorded on a trade date basis. Fair value is based on quoted market prices. Realized gains and losses on the sale of securities are determined based on the sales proceeds less the historical cost of the specific asset sold.

Net investment income represents interest income, realized gains and losses, and the change in the fair value of investments, net of management and investment expenses of \$7,376 and \$7,729 in 2002 and 2001, respectively.

Investment securities are exposed to various risks such as interest rate, market and credit risks. Market values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect the fair value of the Plan's investments.

Reinsurance

Premiums written of \$10,961,225 and \$8,645,401 were ceded to reinsurers for the years ended December 31, 2002 and 2001, respectively, net of ceding commission of \$3,655,580 and \$3,233,445, respectively. As a result of the plan subsidizing premium rate increases for those members with a three-year rate guarantee and an acceptable loss ratio, the plan had negative net earned premium of \$754,395 for the year ended December 31, 2002, net of the ceding commission.

For the years ended December 31, 2002 and 2001, the Plan has not adopted Statement of Financial Accounting Standards No. 113. In accordance with the accounting principles prescribed by GASB Statement No. 10, unpaid losses and loss adjustment expense reserves have been presented net of ceded unpaid losses and loss adjustment expense reserves.

Policy Acquisition Costs

The Plan does not defer agent commissions and certain other administration and underwriting expenses as ceding commissions received from the reinsurers has reduced these costs. The net difference between the administration expenses and the ceding commissions does not vary with the individual issuance and maintenance of the contracts of insurance. Therefore, such costs are expensed as incurred. Agent commissions amounted to \$1,399,087 and \$1,248,684 for the years ended December 31, 2002 and 2001, respectively. The Plan engages an external valuation specialist to perform property appraisals of the Plan's members, for the purpose of evaluating property limits. The Plan incurred \$97,032 and \$325,000 of fees in conjunction with these appraisals for the years ended December 31, 2002 and 2001 respectively.

Management Fees

Fees for all administrative, management and brokerage related services provided to the Plan are based upon a percentage of gross premiums written. Fees for such services amounted to \$1,851,623 and \$1,924,158 for 2002 and 2001, respectively.

Unpaid Losses and Loss Adjustment Expense Reserves

The Plan has not established claims liabilities on reinsured risks except for those that it determined are liabilities which are not covered by reinsurers as further discussed in Note 3. For those risks, the Plan has established claims liabilities that are based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled ("case" reserves) and of claims that have been incurred but not reported ("IBNR" reserves), net of

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

estimated salvage and subrogation. The length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claim costs depend on such complex factors as inflation, changes in doctrines of legal liability and damage awards, the process used in computing claims liabilities does not necessarily result in exact amounts, particularly for coverages such as general liability. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual and industry data that reflects past inflation and on other factors and are considered to be appropriate modifiers of past experience (See Notes 3 and 4 for further discussion).

The methods of making such estimates and establishing the ultimate liability for losses and loss adjustment expenses are reviewed regularly. Management believes that the estimate of the ultimate liability for losses and loss adjustment expenses as of December 31, 2002 and 2001 is reasonable and reflective of anticipated ultimate experience. However, it is possible that the Plan's actual incurred losses and loss adjustment expenses will not conform to the assumptions inherent in the determination of the liability. Accordingly, it is reasonably possible that the ultimate settlement of losses and the related loss adjustment expenses may vary significantly from the estimated amounts included in the accompanying financial statements.

Unearned Premiums

Unearned premiums represent the portion of net premiums written by the Plan related to the unexpired risk period of underlying policies. Net premiums are earned on a pro-rata basis over the term of the related policies.

3. Reinsurance

Prior to September 1, 2002, insurance coverages provided by the Plan were 100% reinsured, up to a limit of \$5,000,000 per occurrence, per member, with the exception of its casualty finite reinsurance coverage. Subsequent to September 1, 2002, the Plan began retaining 5% of the premium and losses on the first \$500,000 casualty treaty and 5% of the first \$1,000,000 property treaty on a quota share basis. The Plan's casualty finite reinsurance coverage includes losses on casualty claims up to \$200,000, subject to aggregate limits. The Plan's casualty finite reinsurance coverage is provided in multiple-year treaties to the Plan and the Ohio Fair Participating Plan ("OFPP") together. Both plans share in the same aggregate limits, which are calculated as a function of combined written premium ceded. Due to recent loss developments in several accident years and the establishment of loss reserves, the Plan is expected to ultimately exceed the casualty finite reinsurance coverage available as of December 31, 2002 related to accident years 1996 to 1999, and would be liable for future claims occurring during those contract periods. Any new claims reported or adverse development on prior accident years will be incurred by the Plan.

In the event that any of the reinsurance companies should be unable to meet their obligations under the existing reinsurance agreements, the Plan would be liable for such defaulted amounts. The Plan evaluates the financial condition of its reinsurers and monitors the concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvencies.

Experience accounts have been established by the Plan's reinsurers in accordance with the terms of the treaties whereby the Plan may receive a refund based upon the loss development of these covered losses. The agreements are effective until all losses are settled or the agreements are

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

commuted. No amounts related to these experience accounts have been recognized by the Plan as of December 31, 2002 and 2001.

4. Unpaid Losses and Loss Adjustment Expense Reserves

Activity in the losses and loss adjustment expense reserves is summarized as follows:

	2002	2001
Balance at January 1	\$ 30,868,395	\$ 15,802,526
Less: reinsurance recoverables	28,745,608	15,794,329
Net balance at January 1	<u>2,122,787</u>	<u>8,197</u>
Incurred related to:		
Current year	43,180	-
Prior year	(1,368,761)	2,115,000
Total incurred	<u>(1,325,581)</u>	<u>2,115,000</u>
Paid related to:		
Current year	937	-
Prior year	41,503	410
Total paid	<u>42,440</u>	<u>410</u>
Net balance at December 31	754,766	2,122,787
Plus: reinsurance recoverables	<u>27,481,833</u>	<u>28,745,608</u>
Balance at December 31,	<u>\$ 28,236,599</u>	<u>\$ 30,868,395</u>

The net balance of unpaid losses and loss adjustment expense reserves at December 31, 2002 represents the Plan's estimate of the ultimate cost of loss and loss adjustment expenses that have been reported but not settled and that have been incurred but not reported, net of estimated salvage and subrogation.

During 2001, the \$2,115,000 of adverse loss development incurred related to new claims filed on accident years 1996 through 2000 and one new claim filed on an old unrecoverable accident year. The majority of these losses were due to adverse uninsured motorist litigation developments in the State of Ohio, which have exposed the Plan to losses not originally intended for coverage by underlying policies. Approximately \$1,500,000 of the losses incurred relate to accident periods August 1999 and prior, for which casualty finite reinsurance coverage is closed to additional premium.

During 2002, approximately \$500,000 of the \$1,368,761 of favorable loss development relates to decreased ultimate loss projections on claims filed on accident years 1996 through 1999, due primarily to settlement of various uninsured motorist and general casualty claims at lower than expected amounts. Approximately \$800,000 of the favorable incurred development is related to additional finite reinsurance limit growth due to increased premiums cession during 2002.

Ohio Government Risk Management Plan

Notes to the Financial Statements, continued

5. Tax Status

On April 27, 1995, the Plan received notification that it is a qualified plan under the applicable sections of the Internal Revenue Code and is therefore not subject to federal income tax under present tax laws.

6. Commitments and Contingencies

On June 30, 2001 the Plan renewed a \$1,000,000 line of credit agreement with Fifth Third Bank of Northwest Ohio, N.A. that expires on June 30, 2003 and is collateralized by the Plan's cash and cash equivalents. As of December 31, 2002 and 2001, the Plan had no borrowings against this line of credit.

The Plan and its individual members are named as defendants in various lawsuits generally relating to their coverage. Numerous legal actions arise from claims made related to coverage provided by the Plan or in connection with previous reinsurance agreements. These actions were considered by the Plan in establishing its losses and loss adjustment expense reserves. The Plan believes the ultimate disposition of these and other pending lawsuits against the Plan will not materially impact the Plan's financial position, results of operations or cash flows.

7. Subsequent Event

On March 31, 2003, the Plan received a payment from the Franklin County Court of Common Pleas in the amount of \$114,382. This amount represents a recovery of a portion of previously unrecoverable reinsured losses from General Casualty Reinsurance Company related to claims occurring prior to July 1, 1991. These funds will be recognized as other income in 2003.

**Report of Independent Accountants
on Supplemental Information**

To the Board of Directors of
the Ohio Governmental Risk Management Plan:

The report on our audits of the financial statements of the Ohio Governmental Risk Management Plan (the "Plan") as of December 31, 2002 and 2001, and for the years then ended is presented on page one of this document. These audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Supplemental Schedule of Ten-Year Claims Development Information of the Plan as of December 31, 2002 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Plan's board of directors, management of the Plan and its members and is not intended to be and should not be used by anyone other than those specified parties.

/s/ PricewaterhouseCoopers LLP

March 31, 2003

