

Financial Statements - Modified Cash Basis
and Other Financial Information



Florida Workers' Compensation Insurance Guaranty Association, Inc.

*Years ended December 31, 2010 and 2009
with Report of Independent Auditors*

Thomas Howell
 Ferguson P.A.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Financial Statements - Modified Cash Basis
and Other Financial Information

Years ended December 31, 2010 and 2009

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Report of Independent Auditors

The Board of Directors
Florida Workers' Compensation Insurance Guaranty Association, Inc.

We have audited the accompanying statements of financial position - modified cash basis of Florida Workers' Compensation Insurance Guaranty Association, Inc. (the Association) as of December 31, 2010 and 2009, and the related statements of activities and changes in net assets - modified cash basis for the years then ended. These financial statements are the responsibility of the Association'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. Those standards require that we plan and perform the audit 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.

As described in Note 1 to the financial statements, these financial statements are prepared on a modified basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The accounting practices used by the Association vary from accounting principles generally accepted in the United States of America, and the Association has not determined the effect of those variances. The variances include omission of assessments receivable and accruals for loss and loss adjustment expense reserves of insolvent insurance companies and self insurance funds assumed by the Association. Accordingly, we were not engaged to audit, and we did not audit, the effects of those variances. Since the accompanying financial statements do not purport to be a presentation in conformity with accounting principles generally accepted in the United States of America, we are not in a position to express, and we do not express, an opinion on the financial statements referred to above as to fair presentation of financial position, results of operations, or cash flows in conformity with accounting principles generally accepted in the United States of America.

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In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of the Florida Workers' Compensation Insurance Guaranty Association, Inc. as of December 31, 2010 and 2009, and its revenue collected and expenses paid for the years then ended on the basis of accounting described in Note 1.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying other financial information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Thomas Howell Ferguson P.A.

March 7, 2011

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Statements of Financial Position - Modified Cash Basis

	December 31,	
	<u>2010</u>	<u>2009</u>
Assets		
Cash and short-term investments:		
Cash and cash equivalents	\$ 7,630,962	\$ 58,374,778
Short-term investments	<u>52,741,971</u>	<u>104,806,519</u>
Total cash and short-term investments	60,372,933	163,181,297
Accrued interest income	738,667	429,629
Investments	122,668,383	22,426,490
Property and equipment, net	<u>1,195,055</u>	<u>1,251,016</u>
Total assets	<u>\$ 184,975,038</u>	<u>\$ 187,288,432</u>
Liabilities and net assets		
Temporarily restricted net assets	<u>184,975,038</u>	<u>187,288,432</u>
Total liabilities and net assets	<u>\$ 184,975,038</u>	<u>\$ 187,288,432</u>

See accompanying notes.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Statements of Activities and Changes in Net Assets -
Modified Cash Basis

	Years ended	December 31,
	2010	2009
Revenues:		
Assessments	\$ -	\$ (154,773)
Investment income, net of related expenses	1,410,398	2,167,289
Estate distributions and claim recoveries	<u>61,942,389</u>	<u>19,987,971</u>
Total revenues	<u>63,352,787</u>	<u>22,000,487</u>
Expenses:		
Claims and claims adjustment expenses paid	64,849,420	39,872,037
Direct estate expenses	(395,799)	99,575
General and administrative expenses	<u>1,212,560</u>	<u>1,366,040</u>
Total expenses	<u>65,666,181</u>	<u>41,337,652</u>
Change in net assets	(2,313,394)	(19,337,165)
Temporarily restricted net assets at beginning of year	<u>187,288,432</u>	<u>206,625,597</u>
Temporarily restricted net assets at end of year	<u>\$ 184,975,038</u>	<u>\$ 187,288,432</u>

See accompanying notes.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

Years ended December 31, 2010 and 2009

1. Organization and Significant Accounting Policies

The Florida Workers' Compensation Insurance Guaranty Association, Inc. (the Association), a not-for-profit corporation, was established through a merger with the Florida Self-Insurance Fund Guaranty Association, Inc. (FSIFGA) and the workers' compensation insurance account within the Florida Insurance Guaranty Association, Inc. (FIGA) on October 1, 1997, pursuant to Chapter 631 of the Florida Statutes. The Association was created to provide a mechanism for the payment of covered workers' compensation claims of insolvent insurers and to assist in the detection and prevention of insurer insolvencies. The Association operates under the supervision and approval of a board of directors, which is comprised of eleven persons, one is the consumer advocate appointed pursuant to Chapter 627.0613, Florida Statutes, one appointed by the Chief Financial Officer of the state of Florida, and nine selected by insurance company and self-insurance fund members, and subsequently appointed by the Florida Department of Financial Services.

The members of the Association are all insurers that provide workers' compensation coverages in the state of Florida.

The funding of the Association's activities is provided by distributions from the estates of insolvent insurers and assessments of members. The assessments are levied on insurers writing workers' compensation coverages in the state of Florida and are levied based on a percentage of net direct written premiums for workers' compensation coverages provided in the immediately preceding calendar year. The maximum assessment rate is 2% and 1.5% for insurance companies and self-insurance funds, respectively. If assessments are insufficient to satisfy claims and administration costs, then an additional assessment of 1.5% may be levied. There were no assessments levied for 2010 and 2009.

The accounting policies and methods of their application that significantly affect the assets and liabilities arising from cash transactions and changes in the modified cash basis net assets of the Association are as follows:

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

1. Organization and Significant Accounting Policies (continued)

Basis of Accounting

The financial statements of the Association are prepared on a modified basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles. This basis of presentation differs from accounting principles generally accepted in the United States of America (GAAP) in that certain revenues are recognized when received rather than earned and certain expenses are recognized when paid rather than when the obligation is incurred. Specifically, the variances from GAAP include omission of assessments receivable and accruals for loss and loss adjustment expense reserves of insolvent insurance companies and self-insurance funds assumed by the Association. Such variances are presumed to be material. However, similar to financial statements prepared in accordance with GAAP, these financial statements reflect the capitalized cost of property and equipment and related depreciation, accrued interest income and amounts held by the Association for others in a fiduciary capacity. The accompanying financial statements are not intended to present the financial position and results of operations in conformity with accounting principles generally accepted in the United States of America.

Cash and Cash Equivalents

Cash and cash equivalents consist of deposits with financial institutions and deposits in highly liquid money market funds with maturities of three months or less. Deposits with financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per depositor. Bank deposits at times may exceed federally insured limits. The Association has not experienced any losses in such accounts.

Investments

Investments are reported at cost with no adjustment for the amortization of bond premium or discount. Short-term investments include securities with original maturity dates of one year or less. Interest income is recorded in the period earned.

Concentration of Credit Risk

The Association's financial instruments exposed to concentrations of credit risk consist primarily of its cash, cash equivalents, short-term investments, and premium revenue.

All investment transactions have credit exposure to the extent that a counterparty may default on an obligation to the Association. Credit risk is a consequence of carrying investment positions. To manage credit risk, the Association focuses primarily on higher quality, fixed income securities, reviews the credit strength of all entities in which it invests, limits its exposure in any one investment, and monitors portfolio quality.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

1. Organization and Significant Accounting Policies (continued)

Property and Equipment

Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets that range from three to 39 years. The Association's policy is to capitalize asset acquisitions greater than \$1,000.

Net Assets

The Association's modified cash basis net assets are temporarily restricted and represent funds held from assessments, distributions from the estates of insolvent insurers, the merger of FSIFGA and the workers' compensation insurance account of FIGA, and other sources to pay covered workers' compensation claims of insolvent insurers and administrative costs as they come due.

Income Taxes

The Association is exempt from federal income taxes under Section 501 of the Internal Revenue Code as a 501(c)(6) organization.

Assessments

Assessments are recorded at the time they are received by the Association.

Estate Distributions and Claim Recoveries

Amounts received by the Association for estate distributions and claim recoveries are recognized in the period received. Estate distributions and claim recoveries include reinsurance recoveries by the Receiver, direct claim recoveries, and any other distribution of estate assets.

Claims and Claims Adjustment Expenses Paid

Claims and claims adjustment expenses paid consist of amounts paid on claims of insolvent insurers.

Direct Estate Expenses

Direct estate expenses are expenses incurred by the Association related directly to the protection of the Association's interest in the administration of specific insolvent insurers' estates.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

1. Organization and Significant Accounting Policies (continued)

General and Administrative Expenses

The Association records general and administrative expenses when paid.

Subsequent Events

The Association has evaluated subsequent events through March 7, 2011, the date the financial statements were available to be issued. During the period from December 31, 2010 to March 7, 2011, the Association did not have any material recognizable subsequent events.

Use of Estimates

The preparation of financial statements in conformity with the modified basis of cash receipts and disbursements 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. Accordingly, actual results could differ from those estimates.

2. Investments

The Association invests in U.S. Treasury securities, agency obligations, corporate bonds, certificates of deposit, and the State of Florida Special Purpose Investment Account. The fair values of investments are estimated based on their quoted market values for the specific investments. The cost and fair value of these investments are as follows:

	December 31, 2010	
	<u>Cost</u>	<u>Fair Value</u>
U.S. Treasury notes	\$ 87,613,030	\$ 87,395,809
U.S. Government agency obligations	62,949,422	62,692,386
Corporate bonds	17,225,633	17,008,658
Certificates of deposit	7,400,000	7,400,000
State of Florida Special Purpose Investment Account	<u>222,269</u>	<u>222,269</u>
	175,410,354	174,719,122
Less short-term investments	<u>52,741,971</u>	<u>52,613,421</u>
Investments	<u>\$ 122,668,383</u>	<u>\$ 122,105,701</u>

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

2. Investments (continued)

	December 31, 2009	
	<u>Cost</u>	<u>Fair Value</u>
U.S. Treasury notes	\$ 46,855,215	\$ 46,909,042
U.S. Government agency obligations	75,590,787	75,566,306
Corporate bonds	4,570,206	4,552,856
State of Florida Special Purpose Investment Account	<u>216,801</u>	<u>216,801</u>
	127,233,009	127,245,005
Less short-term investments	<u>104,806,519</u>	<u>104,750,162</u>
Investments	<u>\$ 22,426,490</u>	<u>\$ 22,494,843</u>

A summary of the cost and fair market value of the Association bonds and other investments at December 31, 2010, by maturity is as follows:

	<u>Cost</u>	<u>Fair Market Value</u>
Due in one year or less	\$ 52,741,971	\$ 52,613,421
Due after one year through five years	122,668,383	122,105,701
Due after five years through 10 years	-	-
Total	<u>\$ 175,410,354</u>	<u>\$ 174,719,122</u>

The foregoing data is based on the expected maturities for bonds. These expected maturities might differ from the contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Investment income consists of interest income and net realized losses and is reported net of investment management expenses of \$116,276 and \$122,376 for the years ended December 31, 2010 and 2009, respectively. Net realized losses for the years ended December 31, 2010 and 2009 were \$426,439 and \$787,540, respectively.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

3. Property and Equipment

Property and equipment consists of the following:

	December 31,	
	<u>2010</u>	<u>2009</u>
Land	\$ 310,000	\$ 310,000
Building	883,463	883,463
Office furniture and equipment	43,697	43,719
Computer equipment and software	225,022	228,113
Leasehold improvements	<u>57,672</u>	<u>57,672</u>
	1,519,854	1,522,967
Less accumulated depreciation	<u>324,799</u>	<u>271,951</u>
	<u>\$ 1,195,055</u>	<u>\$ 1,251,016</u>

Depreciation and amortization expense totaled \$61,866 and \$72,170 for the years ended December 31, 2010 and 2009, respectively.

The Association and FIGA are the owners of real property together with certain tangible property. The Association owns an undivided 50% interest in the property which is reported above as land and building.

4. Management Services Agreements

Effective January 1, 2008, and as amended December 31, 2009, the Association and FIGA entered into agreements with American Guaranty Fund Group, Inc. (AGFG) to provide management and administrative services. Under the terms of the agreement, AGFG provides management and administrative services, including but not limited to general management responsibility, finance and accounting, overseeing and managing the Association's claims division, managing and supervising the day to day activities of the Association, and other management or administrative services. The Association and FIGA reimburse AGFG for all amounts paid by AGFG. Costs incurred by AGFG that are directly attributable to a specific entity are charged to the applicable entity. All other costs incurred by AGFG are distributed equitably to the Association and FIGA based on various allocation methods. The Association's contract may be terminated with 30 days written notice by either party, with or without cause. The Association and FIGA each pay AGFG in advance of each calendar year an amount equal to the two month average budget for that entity projected for the upcoming calendar year. The operating advance paid to AGFG was \$215,910 and \$271,607 at December 31, 2010 and 2009, respectively.

Amounts paid to AGFG under this agreement totaled \$2,436,573 and \$1,890,039 for the years ended December 31, 2010 and 2009, respectively, and are reported in general and administrative expenses, claim handling expenses, and direct estate expenses.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

5. Responsibility for Pre 1994 Claims

Upon creation of FSIFGA in 1994, claims resulting from accidents or losses before January 1, 1994, were specifically excluded from coverage by the enacting legislation. The 1997 legislation that created the Association made it responsible for those pre-1994 claims. The state of Florida provided \$5,000,000 to FSIFGA to provide for pre-1994 claims. Subsequent to the enactment of the legislation in 1997 and upon the merger (Note 1), all pre-1994 claims became the responsibility of the Association and the modified cash basis net assets balance, which included the unexpended portion of the transfer from the state of Florida, was transferred to the Association.

6. Commitments and Contingencies

As more fully described in Note 1, the Association has assumed the outstanding claims and claims adjustment expense liabilities of insolvent workers' compensation insurers in the state of Florida. The case-basis claims and claims adjustment expense reserves for known insolvent insurers at December 31, 2010 and 2009, are approximately \$211,000,000 and \$267,000,000, respectively. An actuarial determination of the ultimate value of the outstanding claim liabilities has not been made.

The Association became responsible during 1999, for an insolvent workers' compensation insurer, Florida Workers' Compensation Fund (FWCF). The insolvent company and the Florida Department of Financial Services (the Receiver) entered into reinsurance contracts with a reinsurer whereby \$40,000,000 in net losses and loss adjustment expense reserves were ceded to a reinsurer. However, should the amount of the losses and loss adjustment expenses exceed \$40,000,000 or the reinsurers be unable to meet their obligations under the contracts, the Association would be liable for the claims payments. In October 2002, by mutual agreement, the reinsurer and Receiver commuted the reinsurance contracts and the Receiver was assigned all rights under certain excess insurance policies of FWCF. Accordingly, the Association became directly liable for the outstanding unpaid claims of FWCF and expects to receive partial recovery of amounts paid from transfer of excess of loss reinsurance recoveries by the Receiver to the Association. The claims and claims adjustment expenses paid and the claims and claims handling reimbursements were \$3,417,372 and \$0, respectively, for the year ended December 31, 2010. The claims and claims adjustment expenses paid and the claims and claims handling reimbursements were \$4,433,832 and \$1,000,000, respectively, for the year ended December 31, 2009. Total case-basis reserves relating to FWCF at December 31, 2010 are approximately \$25,000,000, and are included in the total case-basis claims and claims adjustment expense reserves of insolvent members discussed in the preceding paragraph.

The Association and its predecessors have received early access distributions from the receivers of insolvent insurers. Some of these distributions were received pursuant to agreements that provide that in the event the distributions exceed the Association's final pro rata distribution from the insolvencies, the Association will return any excess to the receiver.

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Notes to Financial Statements - Modified Cash Basis

6. Commitments and Contingencies (continued)

The Association and FIGA entered into an agreement dated December 15, 1999, whereby FIGA would remit to the Association 70% of the outstanding workers' compensation claims expenses currently filed with the various receivers on specific pre-December 31, 1997 insolvencies. Under this agreement, the Association received \$6,794,909 in 1999. The Association is obligated to remit back to FIGA any additional payments received directly from an estate as early access or final distribution on the expense portion of the pre-December 31, 1997 insolvencies. The original agreement was amended on August 24, 2006. The amendment called for the Association to reimburse FIGA for the entire balance due under the original agreement at that time subject to a final reconciliation effective December 31, 2009. As a result of the final reconciliation, FIGA remitted \$1,221,438 to the Association during 2010 as final settlement of the agreement, which is included in estate distributions and claims recoveries. No amounts were remitted during 2009.

During 2002, the Association and the New York Superintendent of Insurance (the Superintendent), as receiver for Frontier Insurance Company (Frontier), reached an oral agreement where the Association advances funds to an administrator for the payment of covered claims for Frontier's Florida claimants. The Superintendent has agreed to reimburse the Association in total for all payments, although there is no written agreement. Payments made during 2010 and 2009 totaled \$602,134 and \$978,708, respectively, which are included in claims and claims adjustment expenses paid, net. Reimbursements received in 2010 and 2009 totaled \$695,407 and \$889,922, respectively. The case-basis claims and claims adjustment expense reserves disclosed in the first paragraph of this note does not include any reserves for Frontier.

During the ordinary course of business, the Association is involved in various litigation. The ultimate outcome of such litigation is uncertain. However, management and legal counsel are of the opinion that any resulting unfavorable outcomes would have minimal adverse economic impact on the Association.

7. Retirement Plan

The Association employees have the option of participating in the American Guaranty Fund Group, Inc. 401(k) Profit Sharing Plan (the Plan). The Plan is available to employees meeting certain entry requirements. The Association makes discretionary employer contributions to the Plan on a matching basis. Employer contributions paid for the years ended December 31, 2010 and 2009, were \$58,405 and \$60,668, respectively.

8. Temporarily Restricted Net Assets

The Association classifies all net assets as temporarily restricted. Net assets are considered restricted by Florida Statutes until expended for Association operations and payment of claims.

Other Financial Information

Florida Workers' Compensation Insurance Guaranty Association, Inc.

Schedule of General and Administrative Expenses

	Years ended December 31,	
	2010	2009
Accounting and auditing	\$ 40,086	\$ 67,831
Bank fees	38,080	34,178
Consulting	880	23,039
Depreciation	61,866	72,170
Dues and publications	43,326	39,024
Furniture and equipment	29,899	27,892
Insurance	47,560	44,480
Legal fees	63,987	77,462
Office supplies and printing	4,881	4,839
Change in operating advance	(55,697)	(78,393)
Postage and shipping	3,276	3,269
Premises	35,318	34,546
Salaries and benefits	822,212	928,323
Taxes and licenses	29,009	31,004
Telephone	13,722	13,359
Travel and meals	34,155	43,017
	<u>\$ 1,212,560</u>	<u>\$ 1,366,040</u>

See report of independent auditors.