SDML Workers' Compensation Fund

Financial Statements With Supplementary Information
With Independent Auditor's Report Thereon
December 31, 2016 and 2015

Contents

RSM US LLP

Independent Auditor's Report

To the Board of Trustees
SDML Workers' Compensation Fund

Report on the Financial Statements
We have audited the accompanying financial statements of SDML Workers' Compensation Fund (Fund) as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit of the Fund's 2016 basic financial statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. We conducted our audit of the Fund's 2015 basic financial statements 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SDML Workers' Compensation Fund as of December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2017, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

RSM US LLP

Sioux Falls, South Dakota
June 29, 2017

SDML Workers' Compensation Fund

Statements of Net Position
December 31, 2016 and 2015

	2016	2015
Assets		
Current assets:		
Cash and cash equivalents (Note 2 and 3)	**$ 3,150,780**	$ 4,522,614
Investments (Note 2 and 3):		
Certificates of deposit	**8,516,090**	5,339,477
Debt securities	**800,123**	518,148
Receivables:		
Reinsurance recoverable on paid losses (Notes 5 and 7)	**306,154**	368,044
Member contributions	**108,463**	56,836
Investment income	**64,787**	63,828
Other	**23,553**	23,011
Prepaid expenses	**588,341**	-
Total current assets	**13,558,291**	10,891,958
Long-term investments (Note 2 and 3):		
Certificates of deposit	**17,161,380**	18,246,109
Debt securities	**1,655,815**	2,505,262
Total long-term investments	**18,817,195**	20,751,371
Other assets:		
Contributed surplus and member equity in NLC Mutual Insurance Company (Note 6)	**1,893,847**	1,834,234
	$ 34,269,333	$ 33,477,563
Liabilities and Net Position		
Current liabilities:		
Current portion of estimated liability for reported and unreported claims and claims adjustment expenses (Notes 5 and 7)	**$ 3,170,185**	$ 3,005,844
Advance member contributions	**2,413,387**	2,787,973
Member contributions refundable	**504,439**	555,767
Accounts payable and accrued expenses	**61,163**	41,058
Total current liabilities	**6,149,174**	6,390,642
Estimated liability for reported and unreported claims and claims adjustment expenses, less current portion (Notes 5 and 7)	**5,748,045**	5,568,211
Total liabilities	**11,897,219**	11,958,853
Net position (Note 9):		
Unrestricted	**22,372,114**	21,518,710
	$ 34,269,333	$ 33,477,563

See notes to financial statements.

SDML Workers' Compensation Fund

Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2016 and 2015

	2016	2015
Operating revenues:		
Member contributions earned, net of renewal and loss control credits of $2,041,657 and $1,694,408 in 2016 and 2015, respectively	**$ 7,080,783**	$ 6,747,543
Less: Reinsurance premiums (Note 5)	**(607,177)**	(592,941)
Net operating revenues	**6,473,606**	6,154,602
Operating expenses:		
Claims and claims adjustment expenses incurred, net (Notes 4, 5 and 7)	**4,473,007**	4,544,786
General and administrative expenses:		
Administrative and service fees (Notes 4 and 8)	**886,158**	895,391
Payroll audit fees	**37,260**	36,000
Professional fees	**36,176**	34,685
Board of Trustee fees and expenses	**31,541**	42,595
Actuarial fees	**25,850**	14,500
Office expense and other	**6,276**	7,626
Insurance expense	**3,529**	3,529
Total general and administrative expenses	**1,026,790**	1,034,326
Dividends to members, return on equity credits (Note 9)	**493,382**	439,398
Total operating expenses	**5,993,179**	6,018,510
Operating income	**480,427**	136,092
Nonoperating revenues:		
Net investment income	**313,364**	320,713
Earned member equity, NLC Mutual Insurance Company (Note 6)	**59,613**	57,735
Total nonoperating revenues	**372,977**	378,448
Change in net position	**853,404**	514,540
Net position:		
Beginning of year	**21,518,710**	21,004,170
End of year	**$ 22,372,114**	$ 21,518,710

See notes to financial statements.

SDML Workers' Compensation Fund

Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Contributions received	$ 6,603,242	$ 7,082,540
Reinsurance premiums paid	(1,196,060)	(615,952)
Underwriting and expenses of operations paid	(1,006,685)	(1,030,816)
Claims and claims adjustment expenses paid	(4,066,942)	(4,248,451)
Dividends to members	(493,382)	(439,398)
Net cash provided by (used in) operating activities	(159,827)	747,923
Cash flows from investing activities:		
Debt securities:		
Sales and maturities	515,707	12,000
Certificates of deposit:		
Purchases	(7,481,972)	(2,538,964)
Sales and maturities	5,390,088	2,921,000
Investment income received, net of investment expenses	364,170	398,101
Net cash provided by (used in) investing activities	(1,212,007)	792,137
Net increase (decrease) in cash and cash equivalents	(1,371,834)	1,540,060
Cash and cash equivalents:		
Beginning of year	4,522,614	2,982,554
End of year	$ 3,150,780	$ 4,522,614
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 480,427	$ 136,092
(Increase) decrease in assets:		
Reinsurance recoverable on paid losses	61,890	(68,481)
Member contributions receivable	(51,627)	11,380
Other receivables	(542)	(23,011)
Prepaid expenses	(588,341)	3,010
Increase (decrease) in liabilities:		
Estimated liability for reported and unreported claims and claims adjustment expenses	344,175	364,816
Advance member contributions	(374,586)	361,950
Member contributions refundable	(51,328)	(38,333)
Accounts payable and accrued expenses	20,105	500
Net cash provided by (used in) operating activities	$ (159,827)	$ 747,923
Supplemental disclosure of noncash investing and financing activities:		
Net decrease in the fair value of investments	$ 51,765	$ 81,050

See notes to financial statements.

Note 1. Nature of Business and Significant Accounting Policies

Reporting entity: SDML Workers' Compensation Fund (the Fund) was formed in 1986 to provide workers compensation coverage for member organizations belonging to the South Dakota Municipal League (SDML) and the South Dakota Association of County Commissioners (SDACC). There were 426 and 416 members of the Fund in 2016 and 2015, respectively, all of which are primarily cities, counties, townships and special districts of the State of South Dakota. The objective of the Fund is to formulate, develop, and administer, on behalf of member organizations, a program of workers' compensation coverage, to obtain lower costs for that coverage, and to develop a comprehensive loss control program. The Fund is supervised by a nine member Board of Trustees.

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

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

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

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

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

Use of estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the estimated liability for reported and unreported claims and claims adjustment expenses, amounts recoverable from reinsurers under excess of loss and aggregate agreements, and the determination of estimated fair values of investments.

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

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

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

Investments: The Fund reports investments (other than certificates of deposit) at fair value in the statements of net position with changes in the fair value of investments reported as investment income. The fair value of investment securities is estimated based on quoted market prices for these or similar investments. If quoted market prices are not available, fair values are based upon quoted or observable market prices of comparable instruments. Certificates of deposit are stated at cost.

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

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

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

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

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

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

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

Contribution deficiency: A contribution deficiency exists when the sum of expected claims costs (including an estimated liability for unreported claims) and all expected claims adjustment expenses, expected dividends, and policy acquisition costs exceed related unearned premiums. The Fund anticipates investment income in determining if a contribution deficiency exists.

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

Estimated liability for reported and unreported claims and claims adjustment expenses: The coverage offered by the Fund is on an occurrence basis which provides for payment of claims that occur during the period of coverage regardless of when the claim is reported. The estimated liability for reported and unreported claims and claims adjustment expenses is based upon data developed by the Fund's administrator and is discounted at a rate of 1.75 percent as of December 31, 2016 and 2015, which had the effect of reducing this liability as of December 31, 2016 and 2015, by approximately $618,000 and $591,000, respectively. Industry experience and statistics were used to develop the estimated liability. The claims history of the Fund was also considered. The liability includes estimates of the costs to settle individual claims which have been reported, plus a provision for claims and costs incurred but not yet reported. A provision for inflation in the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Claims are reduced for subrogation when payment is received, as subrogation amounts are immaterial.

As adjustments to this estimated liability become necessary, such adjustments are reflected in current operations. Management of the Fund believes the estimated liability for reported and unreported claims and claims adjustment expenses is sufficient to cover the ultimate net cost of incurred claims, but such reserves are based on estimates and the ultimate liability may be greater or less than the amounts estimated. An independent actuary assisted management with the establishment of estimated claims liabilities at December 31, 2016 and 2015.

Reclassifications: Certain items in the 2015 financial statements have been reclassified to conform to the current year's presentation format. There was no effect on the change in net position for 2016 as a result of these reclassifications.

Note 2. Deposits and Investments

The Fund's deposits as of December 31, 2016 and 2015, consist of cash, money market funds and certificates of deposit with book balances totaling $28,828,250 and $28,108,200, respectively.

Custodial credit risk – deposits: Custodial credit risk for deposits is the risk that in the event of a bank failure, the Fund's deposits may not be returned to it. The Fund's deposit policy limits maturities of certificates of deposit to no greater than five years. In addition, the investment policy allows the Fund to be invested in certificates of deposit of banks or savings and loan associations organized under the laws of the United States of America and any state thereof which is insured by the FDIC or any similar organization. The Fund's investment policy also states that no certificate of deposit may be for a face amount greater than $250,000.

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

Note 2. Deposits and Investments (Continued)

As of December 31, 2016, the Fund had the following fixed income securities and maturities:

		Investment Maturities (in Years)			
Investment Type	Fair Value/ Carrying Value	Less Than 1	1 - 5	6 - 10	More Than 10
U.S. treasury issues	$ 1,655,815	$ -	$ -	$ 1,267,972	$ 387,843
U.S. treasury securities, zero coupon bonds	800,123	800,123	-	-	-
Total	$ 2,455,938	$ 800,123	$ -	$ 1,267,972	$ 387,843

As of December 31, 2015, the Fund had the following fixed income securities and maturities:

		Investment Maturities (in Years)			
Investment Type	Fair Value/ Carrying Value	Less Than 1	1 - 5	6 - 10	More Than 10
U.S. treasury issues	$ 2,224,691	$ 512,150	$ -	$ 1,313,400	$ 399,141
U.S. treasury securities, zero coupon bonds	798,719	5,998	792,721	-	-
Total	$ 3,023,410	$ 518,148	$ 792,721	$ 1,313,400	$ 399,141

The net decrease in the fair value of investments during 2016 and 2015 was $51,765 and $81,050, respectively. These amounts take into account all changes in fair value (including purchases and sales) that occurred during the year. Gross realized investment gains were $199 and $962 and gross realized investment losses were $33,982 and $12,480 for the years ended December 31, 2016 and 2015, respectively. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that have been held for more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior year and current year.

Custodial credit risk – investments: The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (i.e. broker-dealer) to a transaction, the Fund will not be able to recover the value of its investments that are in the possession of another party.

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

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

Note 3. Fair Value of Financial Instruments

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

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.

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

Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

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

Assets measured at fair value on recurring basis at December 31, 2016 and 2015, respectively, are as follows:

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2016			
U.S. treasury issues	$ 1,655,815	$ -	$ -
U.S. treasury securities, zero coupon bonds	800,123	-	-
	$ 2,455,938	$ -	$ -

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2015			
U.S. treasury issues	$ 2,224,691	$ -	$ -
U.S. treasury securities, zero coupon bonds	798,719	-	-
	$ 3,023,410	$ -	$ -

The fair value of U.S. treasury issues and securities is determined by reference to quoted market prices in an active market (Level 1).

Note 4. Service Agreements

The Fund has an agreement with Insurance Benefits, Inc. (IBI) to provide program administration for the Fund. The agreement expires December 31, 2019. The base fee is adjusted on an annual basis by the greater of 3.5 percent or the annual change in the Consumer Price Index. Fees incurred under the agreement in 2016 and 2015 were $445,424 and $430,361, respectively.

The Fund has an agreement with Claims Associates, Inc. (CAI) to provide administrative, investigative, and adjustment services for claims incurred. The agreement expires December 31, 2019. The base fee is adjusted on an annual basis by the greater of 3.5 percent or the annual change in the Consumer Price Index. The Fund has a deposit of $300,000 with CAI that will be applied towards future claims payments and is recorded against the estimated liability for reported and unreported claims and claims adjustment expenses. The Fund also has other agreements with CAI or its affiliates for rehabilitation services and network utilization savings. Fees incurred under these agreements in 2016 and 2015 were $1,110,332 and $1,201,206, respectively.

Combined fees incurred to IBI and CAI under these agreements totaled $1,555,756 and $1,631,567 in 2016 and 2015, respectively, of which $1,154,874 and $1,244,242, respectively, are included in claims and claims adjustment expenses incurred and the remainder are included in general and administrative expenses.

The Fund has an agreement with Safety Benefits, Inc. to provide a loss control program for members. The agreement states that Safety Benefits, Inc. be compensated based on a fixed fee. The agreement expires December 31, 2019. The base fee is adjusted on an annual basis by the greater of 3.5 percent or the annual change in the Consumer Price Index. Fees incurred in 2016 and 2015 were $319,470 and $310,415, respectively and are included in general and administrative expenses.

The Fund maintains agency accounts with BankWest under a custodial agreement. Fees incurred to BankWest during 2016 and 2015 were $63,760 and $92,704, respectively, all of which and approximately 60 percent during 2016 and 2015, respectively, were allocated to investment expenses and the remainder were allocated to general and administrative expenses.

Note 5. Reinsurance

The Fund utilizes reinsurance agreements to limit maximum loss and minimize exposures on larger risks. During both 2016 and 2015, individual claims are indemnified for amounts in excess of $900,000, with a statutory limit per occurrence, except with respect to employers' liability, in which a sublimit of $2,000,000 applies.

The Fund is liable for any obligations that the reinsurance companies are unable to meet under the reinsurance agreements. Reinsurance recoverables under reinsurance agreements on paid losses as of December 31, 2016 and 2015, were $306,154 and $368,044, respectively. Reinsurance amounts of $8,766,696 and $9,272,164 were deducted from the estimated liability for reported and unreported claims and claims adjustment expenses as of December 31, 2016 and 2015, respectively. During 2016 and 2015, claims expenses were reduced by $514,033 and $658,093, respectively, related to recoveries from reinsurance companies under contract.

The Fund has several structured settlements and annuities in claimants' names to fund future payments to those claimants. The Fund believes there is no material contingent liability related to these instruments. Accordingly, approximately $2,404,000 and $2,504,000 are not reported as an asset or as a liability in the statements of net position as of December 31, 2016 and 2015, respectively.

Note 6. NLC Mutual

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

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

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

The Fund made no capital contributions to NLC Mutual in 2016 and 2015. As of December 31, 2016 and 2015, the Fund's Capital account balance was $1,893,847 and $1,834,234, respectively.

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

The Fund establishes liabilities for both reported and unreported covered events, which includes estimates of both future payments of claims and related claims adjustment expenses. The following is a summary of the changes in those aggregate liabilities for the years ended December 31, 2016, 2015 and 2014 (amounts in thousands).

	2016	2015	2014
Reported and unreported claims and claims adjustment expense liabilities at beginning of year	$ 8,574	$ 8,209	$ 8,376
Incurred claims and claims adjustment expenses:			
Provision for insured events of the current year	5,723	5,362	5,209
Provision for insured events of prior years	(1,250)	(817)	(1,451)
Total incurred claims and claims adjustment expenses	4,473	4,545	3,758
Payments:			
Claims and claims adjustment expenses attributable to insured events of the current year	2,560	2,484	2,346
Claims and claims adjustment expenses attributable to insured events of prior years	1,507	1,764	1,581
Total payments	4,067	4,248	3,927
Less reinsurance recoverables at beginning of year	(368)	(300)	(298)
Plus reinsurance recoverables at end of year	306	368	300
Reported and unreported claims and claims adjustment expense liabilities at end of year	$ 8,918	$ 8,574	$ 8,209

The 2016, 2015 and 2014 decreases in prior years' provisions of incurred claims and claims adjustment expenses resulted from positive loss development experience as more information became known and payments made, offset by accretion of discount on claims liabilities.

Note 8. Related Party Transactions

SDML and SDACC are the sponsoring organizations of the Fund. SDML performs management services for the Fund. Expenses incurred to SDML in 2016 and 2015 were $50,559 and $49,087, respectively. During 2016 and 2015, $65,944 and $64,138, respectively of endorsement fees were paid to SDML, in which a member of the Fund's Board of Trustees is also the executive director of SDML.

During 2016 and 2015, $43,963 and $42,759, respectively of endorsement fees were paid to the SDACC, in which a member of the Fund's Board of Trustees is also the executive director of the SDACC.

Note 9. Net Position

Any surplus monies for a fiscal year in excess of the amount necessary to fulfill all obligations of the Fund for that year may be refunded to the members at the discretion of the Board of Trustees. Return on equity credits were $493,382 and $439,398 during the years ended December 31, 2016 and 2015, respectively. Renewal and loss control credits were $2,041,657 and $1,694,408 during the years ended December 31, 2016 and 2015, respectively. Return on equity credits are reported as an expense of the Fund and renewal and loss control credits are reported as a reduction of member contributions earned in the year in which the member renews. Discretionary dividends are reported as an expense of the Fund in the year declared.

The Fund's Board of Trustees has designated net position for a "deep reserve" which is not available for dividends to members. At December 31, 2016 and 2015, this amount was approximately $9,339,000 and $9,241,000, respectively.

SDML Workers' Compensation Fund

Required Supplementary Information - Schedule of Claims Development Information - Unaudited
For the Ten Years Ended December 31, 2016
(Dollars in Thousands)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net earned member contributions and investment income:										
Earned	$ 5,834	$ 6,170	$ 6,145	$ 6,753	$ 6,976	$ 6,658	$ 6,468	$ 7,023	$ 7,068	$ 7,394
Ceded	319	391	399	436	400	474	541	590	593	607
Net earned	5,515	5,779	5,746	6,317	6,576	6,184	5,927	6,433	6,475	6,787
Unallocated expenses	685	773	831	887	929	926	968	1,013	1,034	1,027
Estimated claims and expenses, end of policy year:										
Incurred	5,905	4,604	4,820	6,315	6,649	5,450	6,859	5,685	6,020	6,237
Ceded	716	245	388	653	383	675	535	476	658	514
Net incurred	5,189	4,359	4,432	5,662	6,266	4,775	6,324	5,209	5,362	5,723
Net paid (cumulative) as of:										
End of policy year	1,645	1,625	1,555	2,202	1,976	2,003	3,090	2,346	2,484	2,560
One year later	2,897	2,579	2,402	3,157	3,689	2,795	4,114	3,134	3,491	
Two years later	3,199	3,090	2,638	3,696	4,473	2,911	4,801	3,326		
Three years later	3,233	3,186	3,440	3,863	4,579	2,965	4,978			
Four years later	3,218	3,331	3,491	4,063	4,621	3,055				
Five years later	3,280	3,454	3,232	4,101	4,643					
Six years later	3,261	3,489	3,239	4,152						
Seven years later	3,451	3,500	3,260							
Eight years later	3,458	3,504								
Nine years later	3,462									
Reestimated ceded claims and expenses	1,354	89	-	-	220	-	147	-	-	-
Reestimated net incurred claims and expenses:										
End of policy year	5,189	4,359	4,432	5,662	6,266	4,775	6,324	5,209	5,362	5,723
One year later	4,189	4,060	3,989	4,912	5,639	3,984	6,130	4,509	5,099	
Two years later	3,881	3,907	3,785	4,861	5,396	3,359	5,964	4,007		
Three years later	3,726	4,198	3,849	4,548	5,002	3,233	5,849			
Four years later	3,598	3,946	3,745	4,812	4,957	3,260				
Five years later	3,723	3,627	3,534	4,746	4,887					
Six years later	3,603	3,731	3,565	4,699						
Seven years later	3,608	3,774	3,422							
Eight years later	3,618	3,763								
Nine years later	3,507									
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	$ (1,682)	$ (596)	$ (1,010)	$ (963)	$ (1,379)	$ (1,515)	$ (475)	$ (1,202)	$ (263)	$ -

RSM

RSM US LLP

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

To the Board of Trustees
SDML Workers' Compensation Fund

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of SDML Workers' Compensation Fund (Fund) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated June 29, 2017.

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as finding 2016-001 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as finding 2016-002 to be a significant deficiency.

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

The Fund’s Responses to Findings
The Fund’s responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Fund’s responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

RSM US LLP

Sioux Falls, South Dakota
June 29, 2017

Finding 2016-001

- *Criteria or specific requirement:* A system of internal controls requires an adequate financial statement close process.

- *Condition:* The Fund did not properly carry over opening balances from December 31, 2015, and record month and year-end adjustments in the general ledger during 2016 to appropriately state several significant account balances.

- *Context:* During 2015 and prior years, the Fund had an agreement with third party service providers to provide financial administration and other financial services for the Fund. Beginning on January 1, 2016, the Fund brought those services in-house. In connection with the transition, the Fund set up its own general ledger chart of accounts and migrated its account balances from the previous providers and began recording general and administrative disbursements through its own cash accounts, among other accounting functions.

- *Effect:* The Fund's 2016 internal financial statements were improperly stated as a result of not properly migrating opening balances from its previous providers and also not identifying and properly recording certain monthly account activity. An audit entry was necessary to adjust opening net position by approximately $9,100,000 and several other audit entries were necessary to properly adjust significant account balances, including receivables, payables, investments and claims liabilities, among other areas, which had the effect of reducing the change in net position (income) by approximately $121,000.

- *Cause:* Management did not have an adequate understanding of the nature of the transactions included in certain of the account balances. Furthermore, account reconciliation procedures were not adequate and appropriate review procedures were not in place to identify these adjustments.

- *Recommendation:* We recommend that the Fund enhance its understanding of all general ledger account transactions, including the nature and expected frequency of such transactions. Account reconciliations should be prepared monthly for all account balances and the Fund should designate an individual with the appropriate accounting knowledge to perform a secondary review of account reconciliations, journal entries and significant account balances, for reasonableness.

- *Views of responsible officials and planned corrective action:* Management intends to work with its third party providers to enhance its understanding of certain general ledger account support and the nature and type of audit adjustments. We will also use this understanding to implement procedures to properly record monthly activity and enhance monthly reconciliation procedures.

Finding 2016-002

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

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

- *Context:* We noted a lack of segregation of duties within the Fund during our audit procedures, specifically gaining an understanding of the Fund's internal controls.

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

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

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

- *Views of responsible officials and planned corrective action:* Management will review the duties assigned to accounting personnel and make changes to assignments, if necessary. We will also evaluate our general ledger software to determine if a change in software is required.