

# **SDML Workers' Compensation Fund**

Financial Statements  
With Supplementary Information  
With Independent Auditor's Report  
December 31, 2022 and 2021

## Contents

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Independent auditor's report	1-3
<hr/>	
Financial statements	
Statements of net position	4
Statements of revenues, expenses and changes in net position	5
Statements of cash flows	6
Notes to financial statements	7-14
Required supplementary information	
Schedule of claims development information—unaudited	15
<hr/>	
Report required by <i>Government Auditing Standards</i>	
Independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	16-17
<hr/>	
Schedule of findings and responses	18
Summary schedule of prior audit findings	19
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RSM US LLP

## Independent Auditor's Report

Board of Trustees  
SDML Workers' Compensation Fund

### Report on the Audit of the Financial Statements

#### **Opinion**

We have audited the financial statements of South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund), as of and for the years ended December 31, 2022 and 2021, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as of December 31, 2022 and 2021, 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.

#### **Basis for Opinion**

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### **Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Fund's ability to continue as a going concern for 12 months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Fund's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Fund's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings and certain internal control-related matters that we identified during the audit.

### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the schedule of claims development information on Page 15 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who 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 has omitted Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. 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 July 6, 2023, 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 grant agreements 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  
July 6, 2023

## SDML Workers' Compensation Fund

### Statements of Net Position December 31, 2022 and 2021

	2022	2021
<b>Assets</b>		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 3,160,020	\$ 2,743,937
Investments (Note 2 and 3):		
Certificates of deposit	5,601,479	6,635,208
Debt securities	1,004,375	-
Receivables:		
Reinsurance recoverable on paid losses (Notes 5 and 7)	675,671	796,316
Member contributions	138,705	108,417
Investment income	101,544	86,369
Other	32,683	33,829
Prepaid expenses	17,850	17,850
<b>Total current assets</b>	<b>10,732,327</b>	<b>10,421,926</b>
Long-term investments (Notes 2 and 3):		
Certificates of deposit	24,706,589	25,366,669
Debt securities	549,390	1,458,282
<b>Total long-term investments</b>	<b>25,255,979</b>	<b>26,824,951</b>
Other assets:		
Contributed surplus and member equity in NLC Mutual Insurance Company (Note 6)	2,368,813	2,328,873
<b>Total noncurrent assets</b>	<b>27,624,792</b>	<b>29,153,824</b>
	<b>\$ 38,357,119</b>	<b>\$ 39,575,750</b>
<b>Liabilities and Net Position</b>		
Current liabilities:		
Current portion of estimated liability for reported and unreported claims and claims adjustment expenses (Notes 5 and 7)	\$ 3,020,424	\$ 3,568,690
Advance member contributions	2,522,456	2,563,973
Member contributions refundable	664,597	806,633
Accounts payable and accrued expenses	33,570	37,725
<b>Total current liabilities</b>	<b>6,241,047</b>	<b>6,977,021</b>
Estimated liability for reported and unreported claims and claims adjustment expenses, less current portion (Notes 5 and 7)	5,959,448	5,203,167
<b>Total liabilities</b>	<b>12,200,495</b>	<b>12,180,188</b>
Net position (Note 9):		
Unrestricted	26,156,624	27,395,562
	<b>\$ 38,357,119</b>	<b>\$ 39,575,750</b>

See notes to financial statements.

## SDML Workers' Compensation Fund

### Statements of Revenues, Expenses and Changes in Net Position Years Ended December 31, 2022 and 2021

	2022	2021
Operating revenues:		
Member contributions earned, net of renewal and loss control credits (Note 9)	\$ 7,852,420	\$ 7,788,769
Less reinsurance premiums (Note 5)	<u>(731,346)</u>	<u>(658,245)</u>
<b>Net operating revenues</b>	<b><u>7,121,074</u></b>	<b><u>7,130,524</u></b>
Operating expenses:		
Claims and claims adjustment expenses incurred, net (Notes 4, 5 and 7)	<u>5,789,290</u>	5,342,043
General and administrative expenses:		
Administrative and service fees (Notes 4 and 8)	1,129,717	1,054,219
Payroll audit fees	47,287	43,988
Professional fees	46,563	34,896
Board of Trustee fees and expenses	33,684	11,067
Actuarial fees	16,500	14,000
Office expense and other	6,539	5,958
Insurance expense	<u>2,057</u>	<u>2,368</u>
<b>Total general and administrative expenses</b>	<b><u>1,282,347</u></b>	<b><u>1,166,496</u></b>
Return on equity credits (Note 9)	<u>783,512</u>	734,043
<b>Total operating expenses</b>	<b><u>7,855,149</u></b>	<b><u>7,242,582</u></b>
<b>Operating loss</b>	<b><u>(734,075)</u></b>	<b><u>(112,058)</u></b>
Nonoperating (expenses) revenues:		
Net investment (loss) income (Note 4)	(544,803)	283,534
Earned member equity, NLC Mutual Insurance Company (Note 6)	<u>39,940</u>	<u>148,288</u>
<b>Total nonoperating (expenses) revenues</b>	<b><u>(504,863)</u></b>	<b><u>431,822</u></b>
<b>Change in net position</b>	<b>(1,238,938)</b>	319,764
Net position:		
Beginning of year	<u>27,395,562</u>	27,075,798
End of year	<b><u>\$ 26,156,624</u></b>	<b><u>\$ 27,395,562</u></b>

See notes to financial statements.

## SDML Workers' Compensation Fund

### Statements of Cash Flows Years Ended December 31, 2022 and 2021

	2022	2021
Cash flows from operating activities:		
Contributions received	\$ 7,638,399	\$ 7,818,890
Reinsurance premiums paid	(730,200)	(650,862)
Underwriting and expenses of operations paid	(1,286,322)	(1,206,803)
Claims and claims adjustment expenses paid	(5,460,630)	(5,515,280)
Dividends to members	(783,512)	(734,043)
<b>Net cash used in operating activities</b>	<b>(622,265)</b>	<b>(288,098)</b>
Cash flows from investing activities:		
Certificates of deposit:		
Purchases	(7,708,189)	(7,668,899)
Sales and maturities	8,362,990	6,816,929
Debt securities:		
Purchases	(247,834)	-
Investment income received, net of investment expenses	631,381	656,281
<b>Net cash provided by (used in) investing activities</b>	<b>1,038,348</b>	<b>(195,689)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>416,083</b>	<b>(483,787)</b>
Cash and cash equivalents:		
Beginning of year	2,743,937	3,227,724
End of year	\$ 3,160,020	\$ 2,743,937
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (734,075)	\$ (112,058)
(Increase) decrease in assets:		
Reinsurance recoverable on paid losses	120,645	(276,861)
Member contributions receivable	(30,288)	(54,244)
Other receivables	1,146	7,383
Prepaid expenses	-	(16,850)
Increase (decrease) in liabilities:		
Estimated liability for reported and unreported claims and claims adjustment expenses	208,015	103,624
Advance member contributions	(41,517)	80,009
Member contributions refundable	(142,036)	4,356
Accounts payable and accrued expenses	(4,155)	(23,457)
<b>Net cash used in operating activities</b>	<b>\$ (622,265)</b>	<b>\$ (288,098)</b>
Supplemental disclosures of noncash investing and financing activities:		
Net decrease in the fair value of investments	\$ (1,191,359)	\$ (361,717)

See notes to financial statements.



## SDML Workers' Compensation Fund

### Notes to Financial Statements

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#### Note 1. Nature of Business and Significant Accounting Policies

**Reporting entity:** South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund) was formed in 1986 to provide workers' compensation coverage for member organizations belonging to SDML and the South Dakota Association of County Commissioners (SDACC). There were 510 and 509 members of the Fund in 2022 and 2021, 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, money market mutual funds, certificates of deposit and debt securities that are not subject to withdrawal restrictions or penalties, and certificates of deposit and debt securities that 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 collectibility of such receivables monthly based on third-party payers' financial condition and credit history, and current economic conditions. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

## SDML Workers' Compensation Fund

### Notes to Financial Statements

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

**Investments:** The Fund reports investments (other than nonnegotiable certificates of deposit) at fair value in the statements of net position with changes in the fair value of investments reported as investment income. Fair value is the price that would be received to sell the investment in an orderly transaction between market participants at the measurement date. Fair value of actively traded securities is determined by the reported market value of securities trading on national exchanges. Values of securities not actively traded are based on observable inputs of similar financial instruments. Nonnegotiable certificates of deposit are stated at cost.

Dividend and interest income is 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 (NLC Mutual):** The Fund records its share of net increases (decreases) in certain net assets of NLC Mutual as income (loss) in the Fund's statements of revenues, expenses and changes in net position and adds (deducts) such amounts to (from) the member equity account included in other assets on the statements of net position.

**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. Member contributions are recorded net of renewal and loss control credits (see Note 9).

## SDML Workers' Compensation Fund

### Notes to Financial Statements

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

**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. At December 31, 2022 and 2021, the Fund determined no contribution deficiency existed.

**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% as of December 31, 2022 and 2021, which had the effect of reducing this liability by approximately \$631,000 and \$552,000 as of December 31, 2022 and 2021, 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 that 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, 2022 and 2021.

#### Note 2. Deposits and Investments

The Fund's deposits as of December 31, 2022 and 2021, consist of cash, money market funds and certificates of deposit with book balances totaling \$33,468,088 and \$34,745,814, 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 that are insured by the Federal Deposit Insurance Corporation 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. As of December 31, 2022 and 2021, deposits of \$1,306,150 and \$1,221,214, respectively, were exposed to custodial credit risk, as they were uninsured, and the collateral was held by the pledging bank not in the Fund's name.

**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. The Fund does not have a policy regarding exposure to custodial credit risk. At December 31, 2022 and 2021, no investments were exposed to custodial credit risk.

## SDML Workers' Compensation Fund

### Notes to Financial Statements

#### Note 2. Deposits and Investments (Continued)

**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.

As of December 31, 2022, the Fund had the following fixed-income securities and maturities:

Investment Type	Fair Value/ Carrying Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. Treasury issues	\$ 1,553,765	\$ 1,004,375	\$ 228,906	\$ 320,484	\$ -
Negotiable certificates of deposit	13,008,624	2,713,479	10,295,145	-	-
	14,562,389	3,717,854	10,524,051	320,484	-
Nonnegotiable certificates of deposit	17,299,444	2,888,000	14,411,444	-	-
Total	<u>\$ 31,861,833</u>	<u>\$ 6,605,854</u>	<u>\$ 24,935,495</u>	<u>\$ 320,484</u>	<u>\$ -</u>

As of December 31, 2021, the Fund had the following fixed-income securities and maturities:

Investment Type	Fair Value/ Carrying Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. Treasury issues	\$ 1,458,282	\$ -	\$ 1,081,407	\$ 376,875	\$ -
Negotiable certificates of deposit	11,374,632	1,855,217	9,519,415	-	-
	12,832,914	1,855,217	10,600,822	376,875	-
Nonnegotiable certificates of deposit	20,627,245	4,779,991	15,847,254	-	-
Total	<u>\$ 33,460,159</u>	<u>\$ 6,635,208</u>	<u>\$ 26,448,076</u>	<u>\$ 376,875</u>	<u>\$ -</u>

The net decrease in the fair value of investments during 2022 and 2021, was \$1,191,359 and \$361,717, 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 \$0 and \$7 for the years ended December 31, 2022 and 2021, respectively. Gross realized investment losses were \$1,220 and \$4,959 for the years ended December 31, 2022 and 2021, respectively.

**Credit risk:** The Fund's approved investment policy and South Dakota Codified Law (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% 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.

## SDML Workers' Compensation Fund

### Notes to Financial Statements

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#### Note 3. Fair Value of Financial Instruments

The fair value framework requires the categorization of assets and liabilities that are measured at fair value into one of three levels based on the assumptions (inputs) used in valuing the assets or liabilities. 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:** Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

**Level 2:** Inputs are observable, 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:** Inputs are unobservable, 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 a recurring basis at December 31 are as follows:

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2022:			
U.S. Treasury issues	\$ 1,553,765	\$ -	\$ -
Negotiable certificates of deposit	13,008,624	-	-
	<u>\$ 14,562,389</u>	<u>\$ -</u>	<u>\$ -</u>

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
December 31, 2021:			
U.S. Treasury issues	\$ 1,458,282	\$ -	\$ -
Negotiable certificates of deposit	11,374,632	-	-
	<u>\$ 12,832,914</u>	<u>\$ -</u>	<u>\$ -</u>

The fair value of U.S. Treasury issues and negotiable certificates of deposit is determined by reference to quoted market prices in an active market (Level 1). There were no transfers between levels in the years ended December 31, 2022 or 2021.

#### 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, 2024. The base fee is adjusted on an annual basis by the greater of 3.50% or the annual change in the Consumer Price Index. The base fee was adjusted by 7.50% for the year ended December 31, 2022. Fees incurred under the agreement in 2022 and 2021 were \$568,701 and \$529,024, respectively.

## **SDML Workers' Compensation Fund**

### **Notes to Financial Statements**

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#### **Note 4. Service Agreements (Continued)**

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, 2024. The base fee is adjusted on an annual basis by the greater of 3.50% or the annual change in the Consumer Price Index. The base fee was adjusted by 7.50% for the year ended December 31, 2022. The Fund has a deposit of \$400,000 with CAI that will be applied toward 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 2022 and 2021 were \$1,366,393 and \$1,257,006, respectively.

Combined fees incurred to IBI and CAI under these agreements totaled \$1,935,094 and \$1,786,030 in 2022 and 2021, respectively, of which \$1,423,264 and \$1,309,909, respectively, is included in claims and claims adjustment expenses incurred, and the remainder is included in administrative and service fees.

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, 2027. The base fee is adjusted on an annual basis by the greater of 3.50% or the annual change in the Consumer Price Index. The base fee was adjusted by 7.50% for the year ended December 31, 2022. Fees incurred in 2022 and 2021 were \$408,419 and \$379,430, respectively, and are included in general and administrative expenses.

The Fund maintains accounts with BankWest under a custodial agreement. Fees incurred to BankWest during 2022 and 2021 were \$72,312 and \$74,349, respectively, which were included in net investment income.

#### **Note 5. Reinsurance**

The Fund utilizes reinsurance agreements to limit maximum loss and minimize exposures on larger risks. During both 2022 and 2021, 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, 2022 and 2021, were \$675,671 and \$796,316, respectively. Reinsurance recoverable amounts of \$8,710,526 and \$8,965,836 were deducted from the estimated liability for reported and unreported claims and claims adjustment expenses as of December 31, 2022 and 2021, respectively. During 2022 and 2021, claims expenses were reduced by \$1,028,566 and \$1,013,531, 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, \$2,080,661 and \$2,268,466 are not reported as an asset or as a liability in the statements of net position as of December 31, 2022 and 2021, respectively.

#### **Note 6. NLC Mutual Insurance Company**

In prior years, the Fund had reinsurance coverage with 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 bylaws.

## SDML Workers' Compensation Fund

### Notes to Financial Statements

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#### Note 6. NLC Mutual Insurance Company (Continued)

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% of Capital and no longer than 10 years at 100% of Capital. This distribution of Capital also requires the approval of NLC Mutual's Board of Directors and the State of Vermont Department of Financial Regulation.

The Fund made no capital contributions to NLC Mutual in 2022 or 2021. As of December 31, 2022 and 2021, the Fund's Capital account balance was \$2,368,813 and \$2,328,873, 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, 2022, 2021 and 2020 (amounts in thousands):

	2022	2021	2020
Reported and unreported claims and claims adjustment expense liabilities at beginning of year	\$ 8,772	\$ 8,668	\$ 9,174
Incurred claims and claims adjustment expenses:			
Provision for insured events of the current year	6,878	5,439	5,373
Provision for insured events of prior years	(1,089)	(97)	(360)
Total incurred claims and claims adjustment expenses	5,789	5,342	5,013
Payments:			
Claims and claims adjustment expenses attributable to insured events of the current year	2,905	2,488	2,433
Claims and claims adjustment expenses attributable to insured events of prior years	2,556	3,027	3,278
Total payments	5,461	5,515	5,711
Less reinsurance recoverables at beginning of year	(796)	(519)	(327)
Plus reinsurance recoverables at end of year	676	796	519
Reported and unreported claims and claims adjustment expense liabilities at end of year	\$ 8,980	\$ 8,772	\$ 8,668

## **SDML Workers' Compensation Fund**

### **Notes to Financial Statements**

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#### **Note 7. Liability for Reported and Unreported Claims and Claims Adjustment Expenses (Continued)**

The 2022, 2021 and 2020 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 the SDACC are the sponsoring organizations of the Fund. SDML performs management services for the Fund. Expenses incurred to SDML in 2022 and 2021 were \$63,008 and \$58,612, respectively, and were recognized in administrative and service fees. During 2022 and 2021, \$69,487 and \$73,157, respectively, of endorsement fees incurred to SDML were recognized in administrative and service fees. A member of the Fund's Board of Trustees is also the executive director of SDML.

During 2022 and 2021, \$46,325 and \$48,772, respectively, of endorsement fees incurred to the SDACC were recognized in administrative and service fees. 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 \$783,512 and \$734,043 during the years ended December 31, 2022 and 2021, respectively. Renewal and loss control credits were \$3,481,226 and \$2,886,984 during the years ended December 31, 2022 and 2021, 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, 2022 and 2021, this amount was approximately \$10,025,000 and \$10,192,000, respectively.

#### **Note 10. Contingencies**

The Fund is a party to certain claims and legal actions arising during the ordinary course of business. It is management's opinion that these matters will not have a material adverse effect on the financial position or results of operations of the Fund.

#### **Note 11. Subsequent Event**

All of the effects of subsequent events that provide additional evidence about conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing the financial statements, are recognized in the financial statements. The Fund does not recognize subsequent events that provide evidence about conditions that did not exist at the balance sheet date but arose after, but before the financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the financial statements from being misleading.

The Fund has evaluated subsequent events through July 6, 2023, the date the financial statements were available to be issued.



## SDML Workers' Compensation Fund

### Required Supplementary Information—Schedule of Claims Development Information—Unaudited For the 10 Years Ended December 31, 2022 (Dollars in Thousands)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Net earned member contributions and investment income:										
Earned	\$ 6,468	\$ 7,023	\$ 7,068	\$ 7,394	\$ 7,748	\$ 8,260	\$ 8,787	\$ 8,659	\$ 8,072	\$ 7,308
Ceded	541	590	593	607	629	653	667	638	658	731
<b>Net earned</b>	<b>5,927</b>	<b>6,433</b>	<b>6,475</b>	<b>6,787</b>	<b>7,119</b>	<b>7,607</b>	<b>8,120</b>	<b>8,021</b>	<b>7,414</b>	<b>6,577</b>
Unallocated expenses	968	1,013	1,034	1,027	1,063	1,089	1,123	1,137	1,166	1,282
Estimated claims and expenses, end of policy year:										
Incurred	6,859	5,685	6,020	6,237	6,013	7,534	5,872	6,108	6,453	7,906
Ceded	535	476	658	514	526	620	539	735	1,014	1,028
<b>Net incurred</b>	<b>6,324</b>	<b>5,209</b>	<b>5,362</b>	<b>5,723</b>	<b>5,487</b>	<b>6,914</b>	<b>5,333</b>	<b>5,373</b>	<b>5,439</b>	<b>6,878</b>
Net paid (cumulative) as of:										
End of policy year	3,090	2,346	2,484	2,560	2,459	2,552	2,394	2,433	2,488	2,905
One year later	4,114	3,134	3,491	3,605	3,358	4,181	4,038	3,865	3,788	-
Two years later	4,801	3,326	3,971	4,285	3,873	4,487	4,933	4,689	-	-
Three years later	4,978	3,612	4,016	4,444	4,446	4,713	5,173	-	-	-
Four years later	5,279	3,639	4,093	4,979	4,471	4,841	-	-	-	-
Five years later	5,346	3,646	4,123	4,988	4,645	-	-	-	-	-
Six years later	5,367	3,663	4,133	4,914	-	-	-	-	-	-
Seven years later	5,391	3,668	4,141	-	-	-	-	-	-	-
Eight years later	5,458	3,671	-	-	-	-	-	-	-	-
Nine years later	5,466	-	-	-	-	-	-	-	-	-
Reestimated ceded claims and expenses	224	-	-	122	-	209	64	-	-	-
Reestimated net incurred claims and expenses:										
End of policy year	6,324	5,209	5,362	5,723	5,487	6,914	5,333	5,373	5,439	6,878
One year later	6,130	4,509	5,099	5,516	4,960	6,263	5,847	5,630	5,083	-
Two years later	5,964	4,007	4,586	5,408	4,970	5,681	6,074	5,135	-	-
Three years later	5,849	4,180	4,482	5,322	4,804	5,655	6,058	-	-	-
Four years later	5,892	4,028	4,406	5,162	4,635	5,680	-	-	-	-
Five years later	5,720	3,973	4,378	5,112	4,737	-	-	-	-	-
Six years later	5,666	3,933	4,316	4,959	-	-	-	-	-	-
Seven years later	5,752	3,923	4,235	-	-	-	-	-	-	-
Eight years later	5,754	3,923	-	-	-	-	-	-	-	-
Nine years later	5,752	-	-	-	-	-	-	-	-	-
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	(572)	(1,286)	(1,127)	(764)	(750)	(1,234)	725	(238)	(356)	-

**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***

**Independent Auditor's Report**

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 (*Government Auditing Standards*), the financial statements of South Dakota Municipal League (SDML) Workers' Compensation Fund (the Fund) as of and for the year ended December 31, 2022, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated July 6, 2023.

**Report on 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) as a basis for designing 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.

*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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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 have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified a deficiency in internal control, described in the accompanying schedule of findings and responses as Finding 2022-001, that we consider to be a significant deficiency.

**Report on 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 financial statements. 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 Response to the Finding**

*Government Auditing Standards* requires the auditor to perform limited procedures on the Fund's response to the finding identified in our audit and described in the accompanying schedule of findings and responses. The Fund's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

**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 results 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  
July 6, 2023

## SDML Workers' Compensation Fund

### Schedule of Findings and Responses Year Ended December 31, 2022

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#### Finding 2022-001

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

**Condition:** Several individuals have access to initiate automated clearing house (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.

**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.

**Repeat Finding?** Yes – Finding 2021-001

**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, including ACH transactions.

**Views of responsible officials and management's planned corrective action:** Management continues to review duties assigned to accounting personnel and evaluate its general ledger software to determine if any changes will allow for proper segregation of duties. With the small staff available, it is difficult to allow for proper segregation of all duties, but management will also consider additional review and approval processes to help mitigate the risk.



## **SDML Workers' Compensation Fund**

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### **SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS FOR THE YEAR ENDED DECEMBER 31, 2022**

Identifying Number: 2021-001, 2020-001, 2019-001, and 2018-001

Audit Finding:

Several individuals have access to initiate automated clearing house (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. The Fund's financial statements are not reviewed by the Board of Trustees on a regular basis.

Corrective Action Taken: The Board of Trustees has begun reviewing the Fund's financial statements on a regular basis during the year ended December 31, 2022. Corrective action not taken on the remaining findings as, consistent with prior years, the same conditions continue to exist due to the limitations of the general ledger and the limited number of individuals involved with the operations of the Fund.