



ADMINISTRATION & FINANCE COMMITTEE
Meeting Minutes

Tuesday, June 5, 2012
IRMA Office
9:30 a.m.

PRESENT: David Clark, Chair David Danielson
George Schafer Dan Nisavic
John Prejzner Kelly Amidei
Andrianna Peterson

ALSO PRESENT: Laura Vesecky Larry Bush
Mary Henzler Brian Goding
Joseph Lee

ABSENT: Janet Binder Scott Anderson
Ron Pfeiffer

I. CALL TO ORDER

Chair Clark called the meeting to order. Roll was taken and a quorum declared.

II. APPROVAL OF MINUTES – February 16, 2012

A motion was made by Danielson and seconded by Nisavic to approve the Administration & Finance Committee meeting minutes of February 16, 2012. A voice vote was taken and the motion carried.

III. FINANCIAL REPORTS

- A. IRMA Financial Statements as of April 30, 2012
- B. IRMA Investment Portfolio as of April 30, 2012
- C. IRMA Payables for the period 1/27/12 – 5/17/12

Clark asked whether anyone had any questions on any of the reports. Clark stated that he had already asked Vesecky about two items on the Expenditures – On-Line Training and Claims Software. Vesecky noted that the On-Line Training is the Police Law Institute and we pay it at the beginning of the year, so when you compare budget to actual YTD it looks like we have overspent. The Claims Software item is a one time maintenance fee that has not been paid yet.

A motion was made by Danielson and seconded by Schafer to approve the Financial Reports as presented. A voice vote was taken and the motion carried.

IV. ACTUARIAL REPORT AS OF 12/31/11

Vesecky explained that the packet contained the narrative of the report and, if anyone wanted to see the entire report, they should let her know and she would forward them an email copy.

Vesecky reported that the development for prior years went down that resulted in transferring about \$1.7 Million from Amounts Due to Members into Members' Reserve. In addition, the Members' Reserve earned about a half a million last year. Vesecky

explained that about \$1 million of the \$1.7 in Members' Reserve is from the 2006 year. A big portion of the reduction in the loss fund was for the most recent years, so that hasn't gone into the Members' Reserve yet.

Vesecky referred to page 57, explaining that the actuary always calculates a preliminary loss fund rate for next year, and it has only gone up about a quarter of a percent. This year, the rate was \$2.259 and next year the preliminary rate is \$2.264, which is really due to an increase in the workers' compensation rate.

A motion was made by Danielson and seconded by Schafer to accept the Actuarial Report for 12/31/11. A voice vote was called and the motion carried.

V. 2011 AUDITED FINANCIAL REPORT (Lee)

Vesecky introduced Joe Lee, Manager of Insurance Services, from McGladrey LLP. Lee explained that he has been on the IRMA account since 2006 and is very familiar with the accounting and auditing. Lee stated that he was going to review the Report to the Administration and Finance Committee that he had distributed and commented that since the Administration and Finance Committee is very important to the control structure of IRMA, encouraged the committee to ask questions.

Lee explained that the auditor's responsibilities have already been addressed in the arrangement letter dated October 24, 2011, which will be attached as part of the final report.

In terms of accounting practices, Lee commented that it was a very calm year in terms of auditing. There were no significant accounting principles that were significant to IRMA. The audit did not identify any significant or unusual transactions that have a lack of authoritative guidance or consensus. They did not discuss any alternative treatments of accounting principles with IRMA management. Lee stated that they would discuss some of the accounting estimates and judgments made by management, and as previously mentioned by Vesecky, the financial statements are provided.

Lee stated that there were no audit adjustments; however, we did have minor reclassifications between investment and cash equivalents. These were approved and posted by management for the audit. There were no uncorrected misstatements during the course of the audit. There were no disagreements with management during the audit. Lee noted that they were not aware of any consultations management had with other accountants during the year on any matters. There were no significant issues arising from the audit to be discussed with management. The auditors did not encounter any difficulties in dealing with management during the audit. Lee noted that attached in Exhibit A is some of the written communication between McGladrey and IRMA management.

Lee reviewed the two main areas of the audit with the highest risk, which are pretty common areas to insurance pools. The first area is Unpaid Losses and Loss Adjustment Expenses. Lee explained that in the chart on page 3 the estimation process used by management is outlined, noting that it was consistent this year with last year. Management books to the central estimate. The actuary has started putting in a range in their actuarial report, where in the past they just gave you a one point estimate and IRMA had booked to it. Lee commented that all the insurance companies he works, there is a range given; however, it is very difficult and a lot of work to go either high or

low in the estimate range, so management has booked to the central estimate. Lee commented that in terms of testing. McGladrey has internal actuaries, who look at the report and have a phone conversation with IRMA's actuary – the input and data are tested to make sure the IRMA actuary is using good data.

The second area is Fair Value of Investment Securities. Lee noted that this is a significant estimate, but it is outsourced to a third party with third party managers. They test the fair values, look at published rates and obtain the underlying investment security listing and test those with some of our third party security providers to make sure the fair values are in an acceptable range.

In Exhibit A – Significant Written Communications between Management and Our Firm – Lee stated that during the audit they identified one minor control deficiency. Lee explained that as part of the audit, they look at the controls of IRMA. They look at segregation of duties and what has been implemented. They also design some tests in the audit to test those controls. Lee noted that in this review and testing, they noticed one deficiency. IRMA has set up internally to receive authorization from each member when they use their excess surplus fund. A sheet is filled out by the member and returned to IRMA signing off on using "x" amount of their excess surplus fund toward their contribution. During 2011 contributions, the auditors noted that one member's sheet wasn't returned; it was communicated orally via telephone, but there was no documentation. Lee reported that this control matter has already been fixed, so all of 2012 sheets have been returned. Lee explained that this is really for the members' benefit, knowing that IRMA has authorization on file of every member's excess surplus fund decisions.

Lee highlighted a few areas of the financial reports. Lee noted that in the Statements of Net Assets, the Unpaid Loss Expenses have gone up slightly this year, but this is not of a significant nature. In Statements of Revenues, Expenses and Changes in Net Assets, IRMA is pretty steady in expenses. If you look at the Members' balances expense, from a non-governmental standpoint, that is your net income for the year. However, since IRMA is a break even entity, any income is expensed into the Members' Fund, so IRMA made \$4.4 million this year aided by good development and losses. Last year, IRMA made \$17.6 million, but most of this difference is in the fair value of investment securities. Lee stated that there was nothing unusual in the Statements of Cash Flows.

Lee referred to Note 2 on page 20 – Unpaid Losses and Allocated Loss Adjustment Expenses. Management books to \$76,272,720 at the end of the year. The rest of the table shows what kind of activity occurred during the year. In the third line of the table – Incurred losses and allocated loss adjustment expenses: decrease in provision for covered events of prior years – it went down \$2.7 million. That means that IRMA had another favorable year of development related to prior years.

Lee stated that the rest of the report has to do with investments and noted that Goding has reviewed this with the committee in depth, so he wasn't going to rehash it.

Vesecky commented that she had included the MD&A in the handouts and asked that the committee take a look at the report and if anyone had any suggested changes, she would need them by next week. Vesecky reported that there were two comments that the GFOA came back with. One was to reclassify certain things on the cash flows, which were done. The second one was very confusing because the GFOA said they didn't understand one of the supplemental schedules that is a balance sheet by years.

Vesecky stated that she didn't understand their comment, so she called the GFOA and they said that they didn't realize that this was a supplemental schedule and their comment was based on one of the financial statements, so we don't need to make any changes. We just have to respond to the comment.

VI. SEGREGATION OF DUTIES

Vesecky stated that included in the packet is a memo on Segregation of Duties that the auditor suggests that we report on every year to confirm that we are still doing all these things.

VII. 1st QUARTER INVESTMENT PERFORMANCE REPORT – Brian Goding

Goding reviewed the 2012 1st Quarter Investment Performance Report, explaining that the report was through March and a lot has happened since then.

Section I of the report has the economic summary and through March we have had about 6 months of great performance. For the 3 month quarter ending March 31st, the U.S. Market was up just under 13% and the International markets were up just under 11%. Bonds were up .3%, which means that they got the coupon with a little bit of depreciation, because interest rates continued to rise during the period. We continue to get virtually nothing on cash investments. In breaking down the US Market into various segments of growth and value, growth continues to value through March 31st. The 200 largest companies in the index did well – 10% - 15%. When you look at the market in terms of sector, the only sector that underperformed in the quarter was utilities – down 1.56%.

Goding reported on IRMA's fund as of March 31st. Goding stated that that we have a target of 50% in equities and we are just slightly over at about 52%. Fixed income's target is 40% and we are over at 42%. We just moved the target from 5% to 10% on alternative investments and we are funded about 5.76%. On the Manager line-up, we added some of the alternatives that we just decided to go with in Siguler Guff. The fund started on December 31, 2011 with \$123,800,000 and ended up at \$134,200,000 on March 31, 2012. Overall, the fund had a good quarter. It was up 7.35% versus the benchmark of 6.80%.

In looking at the Performance Summary for the quarter ending March 31, 2012, Goding noted that he would be handing out an updated summary at the end of his report. In general, the fund did well through March. Most of the managers did well against their respective benchmarks. The biggest laggards were Denver, Legg Mason and Mainstream.

Goding reported that equities went from \$61.7 million to \$69.3 million, fixed income from \$55.2 million to \$56.4 million and alternative investments from \$6 million to \$7.7 million.

Goding distributed a performance summary for the month ending April 30, 2012. Goding pointed out that the fixed income managers did fairly well during that time. Bottom line is that the fund actually had appreciation of about .017% versus the benchmark which was -.03%, so it outperformed by about 0.20%. From a dollar basis, we started with \$134.2 million and ended with \$134.6 million.

Goding distributed information on the two managers who have been underperforming – Legg Mason International Equity and Denver Investment. Goding noted that the information shows their performance year-by-year. Goding stated that Legg Mason had a bad first quarter, but did make up ground in April. For the year, they are about 1% under the benchmark. It was really in 2008 and 2009 that they really struggled. Goding noted that they still think they are a good manager.

Goding stated that Denver doesn't look quite as good. They started out in 2008 and underperformed. They outperformed in 2009, 2010 and 2011. They are down about 2% so far in 2012. Goding stated that they looked very hard at doing a search and coming in with a replacement, but we really think that this manager has a good philosophy and process and over time will do well. Goding stated that right now they are not making a recommendation to replace Denver. Goding stated that by the next Administration & Finance Committee meeting, if they don't see better numbers, he would be coming back with a search.

Goding stated that they would be giving Mainstream until the end of the year to improve their numbers.

Clark stated that we have the one S&P 500 Equity Index and we have the various managers and they have been both up and down in performance to the index, and was curious whether we should consider additional indexes. Goding replied that in past meetings we have talked about that at length and it is certainly something that we can consider down the road. Goding stated that they have always thought that the ability to add value is greater for areas like emerging markets, international markets, small cap, etc. and if you go from the areas that you may have less coverage to the areas where you may have more coverage, such as large cap or S&P 500 stocks, your ability to outperform is greater on the riskier assets. Clark suggested that maybe in some of the searches this is something that could be folded in the analysis – here's the search to replace Denver and as an alternative, here is an index search and why or why not we wouldn't want to go with the index. Goding stated that he could do that.

Vesecky asked Goding to stay for the Cash Flow Report.

VIII. CASH FLOW REPORT

Vesecky stated that in looking over the projected out-flows for the balance of 2012, it looks like we will have to withdraw about \$4 million over the course of the year. Vesecky stated that in the past we haven't wanted to wait until the funds are needed and then just pull out \$4 million. We have laddered the withdrawals by \$1 million at a time. Clark had questioned whether we should do it that way or we just leave it fully invested until we need it and then pull it out then. Goding stated that he could work with it either way, but thought that laddering was the best way to do it – taking out \$1 million each month.

Nisavic asked whether there was an impact with the reorganization of IMET. Vesecky stated that she just thought it lowered our returns last year. The dollar amount didn't change, but the implicit return because they were charging their expenses changed. Vesecky stated that she read that it was how they were charging expenses to the fund – but we didn't lose any money. Nisavic stated that he thought it went down. Nisavic noted that IMET has two funds and asked if we were only in one. Vesecky stated that we are in two. We use their convenience fund a lot. Vesecky reported that she

withdraws funds from that every month to put into Illinois Funds out of which we pay our claims. Nisavic stated that he would like to know what we lost there. Vesecky stated that she would get that for Nisavic.

A motion was made by Prejzner and seconded by Danielson to approve staff's recommendation to withdraw \$1 million in July, August and September and review the cash flow at the September meeting to determine if additional withdrawals are required. A voice vote was taken and the motion carried.

IX. 2012 POTENTIAL INTEREST INCOME CREDIT

Vesecky noted that this year and the year before, \$6 million was returned in Interest Income Credit, and because the 2012 Interest Income Credit is expected to be less than that, staff wanted to give members advance notice. Vesecky indicated that right now it looks like the maximum Interest Income Credit will be \$3,217,806, which is based on the December 31st financial of the previous year.

X. ADDITIONS TO AGENDA

There were no additions to the agenda.

IX. CONFIRMATION OF NEXT MEETING

Clark stated that the next Administration and Finance Committee meeting was scheduled for September 27, 2012, at 9:30 a.m. at the IRMA office.

X. ADJOURNMENT

A motion was made by Peterson and seconded by Danielson to adjourn the meeting. A voice vote was taken and the motion carried.

Submitted by:

Laura Vesecky
Director of Financial Services & Administration

Approved by:

David Clark, Chair
Administration & Finance Committee