

**HEARTLAND INSURANCE
RISK POOL**

JUNE 30, 2015

HEARTLAND INSURANCE RISK POOL

FINANCIAL STATEMENTS
with
INDEPENDENT AUDITORS' REPORT

YEARS ENDED JUNE 30, 2015 AND 2014

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Heartland Insurance Risk Pool
Tama, Iowa

We have audited the accompanying statutory financial statements of Heartland Insurance Risk Pool (the "Pool"), which comprise the statutory statements of admitted assets, liabilities, and surplus as of June 30, 2015 and 2014, and the related statutory statements of income and surplus and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of the Iowa Department of Commerce, Insurance Division. Management is also responsible 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 auditors' 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 opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2, the financial statements are prepared by the Pool on the basis of the financial reporting provisions of the Iowa Department of Commerce, Insurance Division, which is a basis of accounting other than U.S. generally accepted accounting principles, to comply with the requirements of the Iowa Department of Commerce, Insurance Division. The effects on the financial statements of the variances between the statutory basis of accounting described in Note 2 and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to in the first paragraph do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of the Pool as of June 30, 2015 and 2014, or the results of its operations or its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Pool as of June 30, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, on the basis of the financial reporting provisions of the Iowa Department of Commerce, Insurance Division, as described in Note 2.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2015 on our consideration of the Pool's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 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 Pool's internal control over financial reporting and compliance.

Conner Ash P.C.

St. Louis, Missouri
September 15, 2015

HEARTLAND INSURANCE RISK POOL

STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND SURPLUS

	June 30,	2015	2014
ADMITTED ASSETS			
Investments		\$ 6,632,482	\$ 6,830,085
Cash		1,148,735	518,101
		<hr/>	<hr/>
Total cash and investments		7,781,217	7,348,186
Reinsurance recoverable		29,040	-
Premium receivable		15,982	12,578
		<hr/>	<hr/>
		\$ 7,826,239	\$ 7,360,764
		<hr/> <hr/>	<hr/> <hr/>
LIABILITIES AND SURPLUS			
LIABILITIES			
Reserve for losses and loss adjustment expenses (notes 4 and 5)		\$ 2,997,145	\$ 2,807,996
Other liabilities		163,450	135,267
		<hr/>	<hr/>
TOTAL LIABILITIES		3,160,595	2,943,263
SURPLUS		<hr/>	<hr/>
		4,665,644	4,417,501
		<hr/>	<hr/>
		\$ 7,826,239	\$ 7,360,764
		<hr/> <hr/>	<hr/> <hr/>

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL
STATUTORY STATEMENTS OF INCOME AND SURPLUS

Years Ended June 30,	2015	2014
UNDERWRITING OPERATIONS (notes 2, 3, and 4):		
Premiums earned, net of reinsurance	<u>\$ 2,734,118</u>	<u>\$ 2,629,367</u>
Losses and loss expenses incurred, net of reinsurance	<u>2,140,976</u>	2,496,180
Underwriting expenses	<u>456,042</u>	489,918
	<u>2,597,018</u>	2,986,098
NET UNDERWRITING INCOME (LOSS)	137,100	(356,731)
INVESTMENT INCOME	<u>91,043</u>	94,641
NET INCOME (LOSS)	228,143	(262,090)
SURPLUS at beginning of year	4,417,501	4,699,591
CHANGE IN NONADMITTED ASSETS	<u>20,000</u>	<u>(20,000)</u>
SURPLUS at end of year	<u><u>\$ 4,665,644</u></u>	<u><u>\$ 4,417,501</u></u>

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL
STATUTORY STATEMENTS OF CASH FLOWS

Years Ended June 30,	2015	2014
CASH FROM OPERATIONS		
Net premiums collected	\$ 2,730,714	\$ 2,616,789
Net losses and loss adjustment expenses paid	(1,980,867)	(2,328,184)
Underwriting expenses paid	(407,859)	(405,848)
	<hr/>	<hr/>
Cash provided (used) by operations	341,988	(117,243)
Net investment income received	92,751	94,707
	<hr/>	<hr/>
Net cash provided (used) by operations	434,739	(22,536)
CASH FROM INVESTMENTS		
Proceeds from investments sold or matured	788,832	515,216
Cost of investments acquired	(592,937)	(854,512)
	<hr/>	<hr/>
Net cash provided (used) by investing activities	195,895	(339,296)
NET CHANGE IN CASH	630,634	(361,832)
CASH AT BEGINNING OF YEAR	518,101	879,933
	<hr/>	<hr/>
CASH AT END OF YEAR	\$ 1,148,735	\$ 518,101
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes and accountants' report.

HEARTLAND INSURANCE RISK POOL

NOTES TO STATUTORY FINANCIAL STATEMENTS

June 30, 2015 and 2014

1. HISTORY AND BUSINESS ACTIVITY

Heartland Insurance Risk Pool (the "Pool") operates as a self-insured risk pool. The Pool was formed July 1, 1987 and provides insurance coverage to ten rural counties in Iowa.

The Pool self-insures workers' compensation, automobile liability, automobile physical damage, crime, and property lines of business on an occurrence basis. General liability, law enforcement, and public official errors and omissions coverage is written on a claims-made basis.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The Pool prepares its statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division. The statutory accounting financial statements are in accordance with the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual*, subject to any deviations prescribed or permitted by the State of Iowa insurance commissioner. The Pool is currently applying only prescribed accounting practices. Statutory accounting practices, in accordance with NAIC *Accounting Practices and Procedures Manual*, vary in some respects from accounting principles generally accepted in the United States of America (GAAP) and include the following differences: (1) reinsurance recoverables on unpaid losses are netted rather than presented gross; (2) the statutory financial statements do not include a statement of comprehensive income; (3) the statement of cash flows does not include classifications consistent with GAAP, and a reconciliation of net income to net cash provided by operating activities is not provided; and (4) certain assets under GAAP are not included in the statutory financial statements.

Use of estimates

The preparation of statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division, requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash

The Pool maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Pool has not experienced any losses on such accounts. The Pool believes it is not exposed to any significant credit risk on cash.

See accountants' report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Valuation of investments

Investments are comprised of certificates of deposit with varying maturities and are carried at cost, which approximates fair value. The cost of securities sold is based upon the specific identification method. Maturities were as follows at June 30:

	2015	2014
Less than one year	\$2,419,114	\$2,085,918
One to five years	4,213,368	4,744,167
	<u>\$6,632,482</u>	<u>\$6,830,085</u>

Premium income recognition

All policies have a twelve-month term and expire on June 30. As a result, all premiums are earned by the June 30 year-end and are reported net of applicable reinsurance. Subsequent to the end of the policy year, the participants' premiums are adjusted to reflect actual payroll levels as reported by the participant. These adjustments and the related effects on reinsurance premium are reflected in the accompanying financial statements.

Reserve for losses and loss adjustment expenses

The Pool provides liabilities for losses based upon undiscounted aggregate case basis estimates for losses reported; estimates of unreported losses based upon past experience, modified for current trends; and deductions of amounts for reinsurance placed with reinsurers. Losses are reported net of amounts recoverable from salvage and subrogation.

Income taxes

The Pool was formed under Chapter 28E of the Iowa Code and is tax-exempt under Section 115 of the Internal Revenue Code.

Nonadmitted assets

Certain assets, designated as "nonadmitted", are excluded from the statutory financial statements by a direct charge to the fund balance (deficit). Nonadmitted assets consisted of prepayments of service fees of \$0 and \$20,000 as of June 30, 2015 and 2014, respectively.

See accountants' report.

3. SERVICE AGREEMENTS

The Pool has agreements with Risk Management Solutions of Iowa, Inc., and Arthur J. Gallagher & Co. to act as a service agent for the self-insured lines of business and provide administrative, brokerage and loss control services. The Pool has an agreement with Creative Risk Solutions to provide claims services. The service fees for the years ended June 30, 2015 and 2014 were as follows:

	<u>2015</u>	<u>2014</u>
Claims services	\$119,000	\$119,000
Administrative services	123,731	120,126
Brokerage services	75,000	75,000
Loss control services	80,000	80,000
	<u>\$397,731</u>	<u>\$394,126</u>

4. REINSURANCE

The Pool cedes insurance to other insurers in order to limit its maximum loss through risk diversification. Insurance ceded by the Pool does not relieve its primary liability as the originating insurer. The amounts deducted for reinsurance ceded were as follows:

	<u>Direct</u>	<u>Ceded</u>	<u>Net</u>
2015:			
Premiums written and earned	\$3,976,960	\$1,242,842	\$2,734,118
Losses and loss adjustment expenses incurred	\$2,151,447	\$ 10,471	\$2,140,976
Reserve for losses and loss adjustment expenses	\$3,506,270	\$ 509,125	\$2,997,145
2014:			
Premiums written and earned	\$3,769,021	\$1,139,654	\$2,629,367
Losses and loss adjustment expenses incurred	\$2,972,699	\$ 476,519	\$2,496,180
Reserve for losses and loss adjustment expenses	\$3,585,317	\$ 777,321	\$2,807,996

See accountants' report.

4. REINSURANCE – CONTINUED

The basic ceded reinsurance treaties benefiting the Pool apply to risks on an excess basis. The base per occurrence retention levels of the Pool are as follows:

Policy period ended	Workers' compensation	Auto, law enforcement, public official and general liability	Property
Through June 30, 2002	\$350,000	\$250,000	\$ 50,000
June 30, 2003	\$350,000	\$350,000	\$100,000
June 30, 2004	\$500,000	\$350,000	\$100,000
June 30, 2005 - 2015	\$750,000	\$400,000	\$100,000

The Pool does not have aggregate reinsurance for periods after June 30, 2002. The workers' compensation reinsurance policy periods ending June 30, 2015 and 2014 have \$250,000 corridors; this means that the Pool must pay an additional \$250,000 on its first loss exceeding the retention level before the reinsurer becomes liable.

5. RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

Activity in reserve for losses and loss adjustment expenses is summarized as follows:

	2015	2014
Balance as of July 1, net of reinsurance recoverable of \$777,321 in 2014 and \$493,850 in 2013.	\$2,807,996	\$2,640,000
Incurred related to:		
Current year	1,627,660	1,840,309
Prior years	513,316	655,871
Total incurred	2,140,976	2,496,180
Paid related to:		
Current year	545,919	752,772
Prior years	1,405,908	1,575,412
Total paid	1,951,827	2,328,184
Balance as of June 30, net of reinsurance recoverable of \$509,125 in 2015 and \$777,321 in 2014	\$2,997,145	\$2,807,996

See accountants' report.

5. RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES – CONTINUED

The reserving process relies on the basic assumption that past experience, adjusted for the effect of current developments and likely trends, is an appropriate basis for predicting future events. Reserve amounts are necessary based on management's informed estimates. As other data becomes available and is reviewed, these estimates and judgments are revised, resulting in increases and decreases to existing reserves. As a result of changes in estimates of ultimate losses on insured occurrences in prior years, the Pool had unfavorable development of \$513,316 in 2015 and \$655,871 in 2014. Development for losses and loss adjustment expenses on prior years can vary significantly due to the small size of the Pool. As of June 30, 2015, the Pool expects reinsurance recoveries of \$509,125 from General Reinsurance Corporation.

6. CONTINGENCIES

The Pool is subject to lawsuits arising in the normal course of the insurance business. The Pool believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or its results of operations. The Pool has reserves which are believed adequate to cover any potential liabilities arising out of all such pending or threatened proceedings.

7. SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 15, 2015, the date on which the financial statements were available to be issued.

See accountants' report.