

MINNESOTA FAIR PLAN

STATUTORY FINANCIAL STATEMENTS  
TOGETHER WITH  
INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2015

# MINNESOTA FAIR PLAN

## CONTENTS

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	<u>Page</u>
INDEPENDENT AUDITORS' REPORT	1-2
FINANCIAL STATEMENTS:	
Statutory Statements of Admitted Assets, Liabilities and Members' Equity	3
Statutory Statements of Operations	4
Statutory Statements of Changes in Members' Equity	5
Statutory Statements of Cash Flows	6
Notes to Statutory Financial Statements	7-12

## **INDEPENDENT AUDITORS' REPORT**

Governing Board of Directors  
Minnesota FAIR Plan  
Minneapolis, Minnesota

### **Report on the Financial Statements**

We have audited the accompanying statutory financial statements of the Minnesota FAIR Plan (a nonprofit organization), which comprise the statutory statements of admitted assets, liabilities and members' equity as of December 31, 2015 and 2014, and the related statutory statements of operations, changes in members' equity 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 prescribed or permitted by the Department of Commerce of the State of Minnesota. 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.

### **Auditors' 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of 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 opinions.

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

As described in Note 2, the financial statements were prepared by the Minnesota FAIR Plan on the basis of the financial reporting provisions prescribed or permitted by the Department of Commerce of the State of Minnesota, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the requirements of the Department of Commerce of the State of Minnesota. The effects on the financial statements of the variances between the regulatory basis of accounting described in Note 2 and accounting principles generally accepted in the United States of America, 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 accounting principles generally accepted in the United States of America, the financial position of the Minnesota FAIR Plan as of December 31, 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 in the first paragraph present fairly, in all material respects, the admitted assets, liabilities, and members' equity of Minnesota FAIR Plan as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in accordance with financial reporting provisions prescribed or permitted by the Department of Commerce of the State of Minnesota as described in Note 2.

St. Paul, Minnesota  
June 9, 2016

*Olsen Thielen + Co., Ltd.*

## MINNESOTA FAIR PLAN

### STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND MEMBERS' EQUITY DECEMBER 31, 2015 AND 2014

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	<u>2015</u>	<u>2014</u>
ADMITTED ASSETS		
Cash and Cash Equivalents	<b>\$ 5,680,875</b>	\$ 1,365,557
Bank Certificates of Deposit, at Cost, Matured in 2015	-	5,002,996
Accrued Interest on Bank Certificates of Deposit	-	6,920
Computer Equipment, at Cost, Net of Accumulated Depreciation of \$643,162 and \$643,162	<u>-</u>	<u>-</u>
 TOTAL ADMITTED ASSETS	 <b><u>\$ 5,680,875</u></b>	 <b><u>\$ 6,375,473</u></b>
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES:		
Unpaid Losses and Loss Adjustment Expenses	<b>\$ 824,822</b>	\$ 832,422
Unearned Premiums	<b>1,630,832</b>	1,566,782
Accounts Payable and Accrued Expenses	<b>246,682</b>	268,790
Total Liabilities	<b><u>2,702,336</u></b>	<u>2,667,994</u>
 MEMBERS' EQUITY	 <b><u>2,978,539</u></b>	 <u>3,707,479</u>
 TOTAL LIABILITIES AND MEMBERS' EQUITY	 <b><u>\$ 5,680,875</u></b>	 <b><u>\$ 6,375,473</u></b>

*The accompanying notes are an integral part of the statutory financial statements.*

## MINNESOTA FAIR PLAN

### STATUTORY STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2015 AND 2014

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	<u>2015</u>	<u>2014</u>
UNDERWRITING INCOME:		
Premiums Earned	<u>\$ 4,252,383</u>	<u>\$ 4,233,144</u>
UNDERWRITING LOSSES AND EXPENSES:		
Losses and Loss Adjustment Expenses	<u>2,088,040</u>	1,687,741
Commissions	<u>260,615</u>	269,081
Other Underwriting Expenses	<u>2,730,361</u>	<u>2,688,321</u>
Total Underwriting Losses and Expenses	<u>5,079,016</u>	<u>4,645,143</u>
UNDERWRITING LOSS	<u>(826,633)</u>	(411,999)
INVESTMENT INCOME	<u>7,312</u>	<u>8,789</u>
NET LOSS	<u>\$ (819,321)</u>	<u>\$ (403,210)</u>

*The accompanying notes are an integral part of the statutory financial statements.*

## MINNESOTA FAIR PLAN

### STATUTORY STATEMENTS OF CHANGES IN MEMBERS' EQUITY YEARS ENDED DECEMBER 31, 2015 AND 2014

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	<u>2015</u>	<u>2014</u>
BALANCE at Beginning of Year	<b>\$ 3,707,479</b>	\$ 4,205,515
Net Loss	<b>(819,321)</b>	(403,210)
Change in Non-Admitted Assets	<b><u>90,381</u></b>	<u>(94,826)</u>
BALANCE at End of Year	<b><u>\$ 2,978,539</u></b>	<b><u>\$ 3,707,479</u></b>

*The accompanying notes are an integral part of the statutory financial statements.*

## MINNESOTA FAIR PLAN

### STATUTORY STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Insurance Premiums Collected	\$ 4,316,433	\$ 4,211,042
Interest Received	14,232	9,436
Insurance Claims Paid, Net of Recoveries of \$0 and \$2,627	(1,957,340)	(1,544,614)
Loss Adjustment Expenses Paid	(138,300)	(185,220)
Commissions Paid to Agents and Brokers	(256,971)	(269,394)
Cash Paid to Suppliers and Employees	(2,756,113)	(2,697,798)
Net Cash Used In Operating Activities	(778,059)	(476,548)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of Bank Certificates of Deposit	-	(5,002,996)
Proceeds from Bank Certificates of Deposit	5,002,996	5,504,492
Change in Non-Admitted Assets	90,381	(94,826)
Net Cash Provided By Investing Activities	5,093,377	406,670
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>4,315,318</b>	<b>(69,878)</b>
<b>CASH AND CASH EQUIVALENTS at Beginning of Year</b>	<b>1,365,557</b>	<b>1,435,435</b>
<b>CASH AND CASH EQUIVALENTS at End of Year</b>	<b>\$ 5,680,875</b>	<b>\$ 1,365,557</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Reconciliation of Net Loss to Net Cash		
Used In Operating Activities:		
Net Loss	\$ (819,321)	\$ (403,210)
Adjustments to Reconcile Net Loss to Net Cash		
Used In Operating Activities:		
Change in:		
Accrued Interest on Bank Certificates of Deposit	6,920	647
Unpaid Losses and Loss Adjustment Expenses	(7,600)	(42,093)
Unearned Premiums	64,050	(22,102)
Accounts Payable and Accrued Expenses	(22,108)	(9,790)
Net Cash Used In Operating Activities	\$ (778,059)	\$ (476,548)

*The accompanying notes are an integral part of the statutory financial statements.*



# MINNESOTA FAIR PLAN

## NOTES TO STATUTORY FINANCIAL STATEMENTS

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### NOTE 1 - NATURE OF OPERATIONS

The Minnesota FAIR Plan (the Plan) was established by the legislature of the State of Minnesota in accordance with the provisions of the Minnesota FAIR Plan Act of 1969. The purpose of the Plan is to provide limited property insurance coverage for eligible property owners when insurance is not available through voluntary markets. The membership of the Plan includes every property insurer authorized to write property insurance in the State of Minnesota. The Plan's Governing Board of Directors has the authority to assess all property insurance companies (hereinafter referred to as Members) that are licensed and write premiums in the state of Minnesota.

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The Plan prepares its financial statements in accordance with accounting practices prescribed or permitted by the Department of Commerce of the State of Minnesota. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners, as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed. Statutory practices vary in certain respects from accounting principles generally accepted in the United States of America. The effects of such variances on the accompanying financial statements have not been determined. However, these differences are presumed to be material. The most significant variances are the charging of acquisition costs (principally commissions and premium taxes) to operations as incurred rather than ratably as the related premiums are earned, and the designation of certain assets as non-admitted for financial statement purposes.

#### Accounting Estimates

The preparation of the financial statements in conformity with statutory practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The most significant area which requires the use of management's estimates is unpaid losses and loss adjustment expenses.

#### Subsequent Events

In preparing these financial statements, the Plan has evaluated for recognition or disclosure the events or transactions that occurred through June 9, 2016, the date the financial statements were available to be issued.

#### Cash and Cash Equivalents

All highly liquid debt instruments purchased with original maturities of three months or less are considered cash equivalents. The Plan's cash and cash equivalents are concentrated primarily within one financial institution.

# MINNESOTA FAIR PLAN

## NOTES TO STATUTORY FINANCIAL STATEMENTS

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### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Computer Equipment

Computer equipment is stated at the lower of cost less accumulated depreciation, or the amount allowable as admitted assets. Depreciation is computed using the straight-line method over the estimated useful lives of three to five years.

#### Unpaid Losses and Loss Adjustment Expenses

Insurance losses and related adjustment expense are charged to operations as incurred. The liability for unpaid losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. These liabilities are necessarily based on estimates and, while management believes that the amounts are adequate, the ultimate liabilities may exceed or be less than the amounts provided. The methods for making the estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in current operations.

#### Taxes

The Plan pays, on behalf of its Members, premium taxes to the state of Minnesota. The Plan is a nonprofit organization exempt from federal income taxes under Section 501(c)(6) of the Internal Revenue Code, and from state income taxes under Section 290.05 of the Minnesota statutes.

#### Non-Admitted Assets

Certain assets, primarily furniture and equipment, purchased computer hardware and software (exceeding 3% of admitted assets), prepaid expenses and prepaid pension costs are designated as "non-admitted assets". The net change in these assets is reflected directly in members' equity. The aggregate net book value of these non-admitted assets was \$471,618 and \$561,999 as of December 31, 2015 and 2014, respectively.

#### Assessments

When made, member assessments are reflected in the accompanying statutory statements of changes in members' equity and represent amounts approved by the Governing Board of Directors and billed to the Members during the year. As defined by state statute, assessments are allocated to the Members based upon each Member's pro rata share of total premiums written in the state of Minnesota for selected lines of business two years prior to the year of assessment. Assessments, when necessary, are used to fund the ongoing operations of the Plan. There were no member assessments in either 2015 or 2014.

#### Premiums

Premiums are earned on a pro rata basis over the term of the policies. Premiums applicable to the unexpired terms of the policies in force are reported as "unearned premiums" at December 31, 2015 and 2014.

# MINNESOTA FAIR PLAN

## NOTES TO STATUTORY FINANCIAL STATEMENTS

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Policy Acquisition Costs

Commissions and other acquisition costs related to premiums written are charged to operations when the premiums are paid by the policyholder.

#### Research and Development

Research and development costs are charged to operations as incurred. Research and development costs consist of software development and were \$596,888 and \$545,579 in 2015 and 2014. Research and development costs are included in other underwriting expenses on the statutory statement of operations.

### NOTE 3 - UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The changes in unpaid losses and loss adjustment expenses for the years ended December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Balance at Beginning of Year	\$ <u>832,422</u>	\$ <u>874,515</u>
Incurred During the Year:		
Losses	1,960,005	1,502,579
Loss Adjustment Expenses	128,035	185,162
Total Incurred	<u>2,088,040</u>	<u>1,687,741</u>
Paid During the Year:		
Losses	1,957,340	1,544,614
Loss Adjustment Expenses	138,300	185,220
Total Paid	<u>2,095,640</u>	<u>1,729,834</u>
Balance at End of Year	\$ <u>824,822</u>	\$ <u>832,422</u>

### NOTE 4 - MEMBERS' EQUITY

The members' equity represents the accumulated results from operations and assessments and the effects of changes in non-admitted assets through December 31, 2015. No distributions have been made to the members since the inception of the Plan.

### NOTE 5 - RETIREMENT PLANS

The Plan is a participating employer of the Pension Plan of Insurance Organizations (PPIO), a multi-employer defined benefit pension plan which covers all eligible employees.

## MINNESOTA FAIR PLAN

### NOTES TO STATUTORY FINANCIAL STATEMENTS

#### NOTE 5 - RETIREMENT PLANS (Continued)

Information with respect to the Plan's participation in this plan for the years ended December 31, 2015 and 2014 is as follows:

#### Change in Plan Assets, Obligations and Funded Status

	2015	2014
Pension Benefits:		
Benefit Obligation at Beginning of Year	\$ 2,737,920	\$ 2,145,320
Service Cost	77,625	60,428
Interest Cost	109,506	101,595
Contributions by Plan Participants	-	-
Actuarial (Gain) Loss	(125,189)	445,317
Benefits Paid	(22,055)	(14,740)
Plan Amendments	82,411	-
Benefit Obligation at End of Year	\$ 2,860,218	\$ 2,737,920
Change in Plan Assets:		
Fair Value of Plan Assets at Beginning of Year	\$ 2,655,316	\$ 2,360,827
Actual Return on Plan Assets	(37,866)	209,229
Employer Contributions	-	100,000
Contributions by Plan Participants	-	-
Benefits Paid	(22,055)	(14,740)
Fair Value of Plan Assets at End of Year	\$ 2,595,395	\$ 2,655,316
Fund Status:		
Prepaid Benefit Costs	\$ 679,695	\$ 591,705
Overfunded Plan Assets	-	-
Liability for Pension Benefits	(264,823)	(82,604)
Total Assets (Nonadmitted)	\$ (414,872)	\$ (509,101)

#### Change in Plan Assets, Obligations and Funded Status (Continued)

	2015	2014
Net Period Benefit Cost:		
Service Cost	\$ 77,625	\$ 60,428
Interest Cost	109,506	101,595
Expected Return on Plan Assets	(158,412)	(146,139)
Gains and Losses	59,040	-
Prior Service Cost or Credit	6,470	6,469
Professional Fees	2,500	4,000
Benefit Cost Recognized for the Year in the Statements of Operations - Statutory Basis	\$ 96,729	\$ 26,353

## MINNESOTA FAIR PLAN

### NOTES TO STATUTORY FINANCIAL STATEMENTS

#### NOTE 5 - RETIREMENT PLANS (Continued)

##### Effect on Members Equity

	2015	2014
Amounts in Members' Equity Recognized as Components of Net Periodic Benefit Cost:		
Items Not Yet Recognized as a Component of Net Periodic Cost - Prior Year	\$ 591,705	\$ 215,947
Net Prior Service Cost Arising During the Period	82,411	-
Net Prior Service Cost Recognized	(6,470)	(6,469)
Net Gain and Loss Arising During the Period	71,089	382,227
Net Gain and Loss Recognized	(59,040)	-
Items Not Yet Recognized as a Component of Net Periodic Cost - Current Year	\$ 679,695	\$ 591,705
Amounts in Members' Equity that Have Not Yet Been Recognized as Components of Net Periodic Benefit Cost:		
Net Prior Service Cost	\$ 82,411	\$ 6,470
Net Recognized Gains and Losses	597,284	585,235
	\$ 679,695	\$ 591,705

##### Assumptions

	2015	2014
Weighted-Average Assumptions Used to Determine Benefit Obligations at End of Year:		
Discount Rate	4.25%	4.00%
Rate of Compensation Increase	3.00%	3.00%
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Costs at Beginning of Year:		
Discount Rate	1.00%	4.75%
Average Rate of Compensation Increase	3.00%	3.00%
Expected Return on Plan Assets	6.00%	6.25%

##### Plan Assets

The Plan assets by asset category at December 31 are as follow:

	2015	2014
Equity Securities	40.10%	50.10%
Debt Securities	58.70	48.90
Cash	1.20	1.00
	100.00%	100.00%

The target asset allocations are 60% for equity securities and 40% for debt securities.

## MINNESOTA FAIR PLAN

### NOTES TO STATUTORY FINANCIAL STATEMENTS

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#### NOTE 5 - RETIREMENT PLANS (Continued)

##### Cash Flows

Expected future benefit payments are as follows:

2016	\$ 66,263
2017	99,761
2018	121,677
2019	137,734
2020	152,203
2021 - 2025	963,276
	<u>\$ 1,540,914</u>

The Plan also participates in a multi-employer 401(k) savings plan which is available to all eligible employees. Employees may make before-tax and/or after-tax contributions of not less than 1% and not more than 75% of their annual compensation, as permitted by law. The Plan matches 100% of the first 1% of employees' contributions and 70% of the next 5% of employees' contributions. The Plan's contribution is made each pay period. The Plan recognized \$35,862 and \$37,197 in expense relating to this plan during the years ended December 31, 2015 and 2014, respectively.

#### NOTE 6 - COMMITMENTS

The Plan has a lease for office space expiring August 2021. In addition to rent, the Plan pays maintenance and operating costs on the leased office space. Rent expense and aggregate rent payments due on the non-cancelable operating lease over the remaining lease term are as follows:

Expense:	
<b>2015</b>	<b>\$ 89,664</b>
2014	87,592
Commitments:	
2016	\$ 44,242
2017	46,223
2018	48,204
2019	50,185
2015	52,166
Thereafter	<u>35,658</u>
Total	<u>\$ 276,678</u>