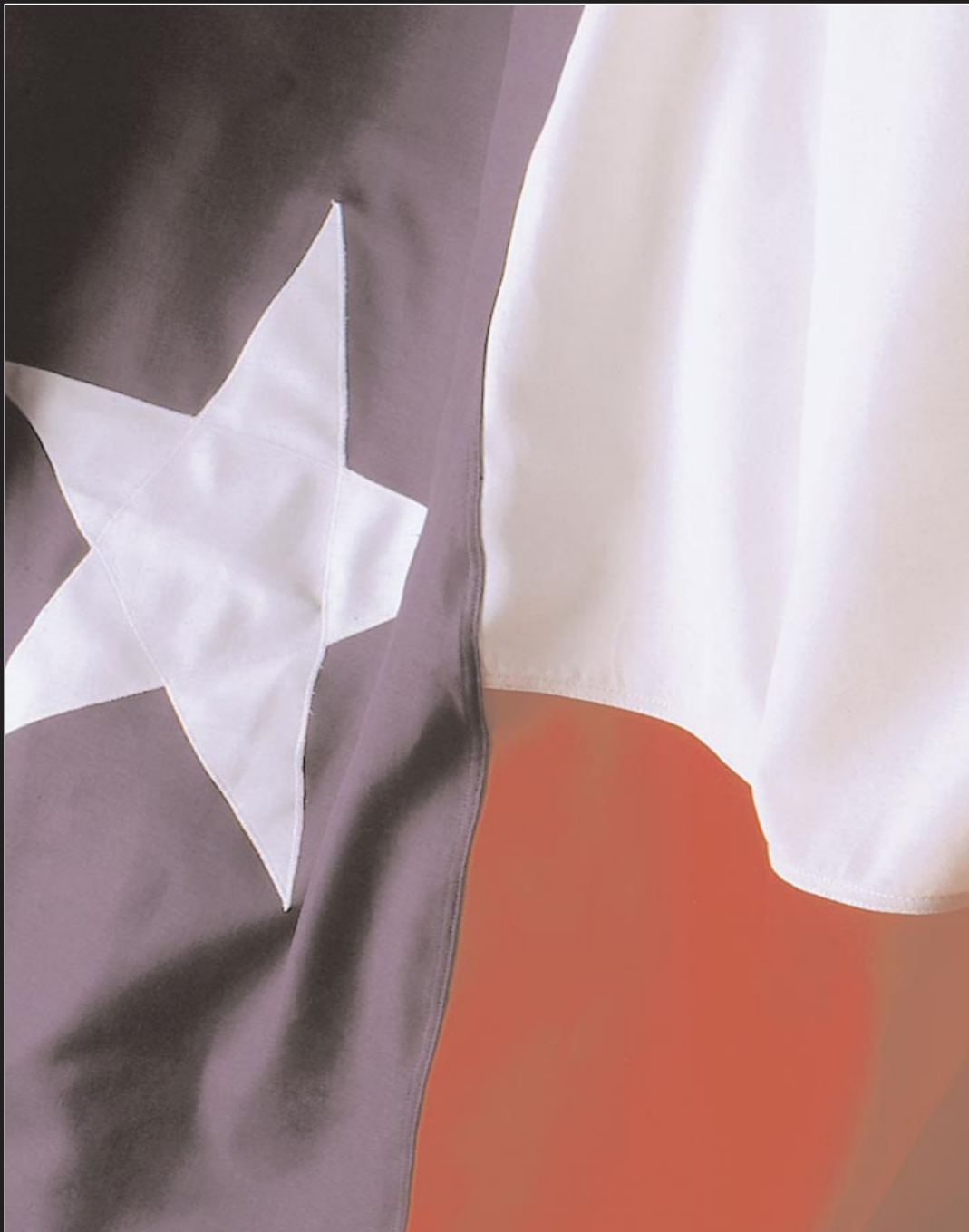


**TEXAS MUNICIPAL LEAGUE
INTERGOVERNMENTAL RISK POOL**



**2001 – 2002
ANNUAL REPORT**

TABLE OF CONTENTS

3 LETTER FROM THE CHAIR

5 THE YEAR IN REVIEW

12 GASB 31 EXPLANATIONS

16 MANAGEMENT'S DISCUSSION & ANALYSIS

23 EXCESS INSURANCE

24 ORGANIZATIONAL CHART

25 FINANCIAL STATEMENTS

77 MEMBERS BY REGION

MANAGEMENT'S DISCUSSION & ANALYSIS

The Texas Municipal League Intergovernmental Risk Pool herein sets forth a narrative overview and analysis of its financial activities for fiscal year ended September 30, 2002.

Financial Highlights

- Assets exceeded Pool Liabilities at September 30, 2002, by \$211.4 million and no amounts were designated as restricted as of the end of the year. Due to the nature of the Pool's relationship with its members, the Pool presents net assets (total assets - total liabilities) as Accumulated Members' Equity. The Pool's governing Board of Directors determines if, how much, and when Accumulated Members' Equity distributions are to be made, based on the Pool's long-term financial needs.
- Combined Accumulated Members' Equity decreased by \$6.2 million in 2001-2002 due primarily to a significant increase in both the frequency and severity of Workers' Compensation claims; flood, hail and wind property damage from late season storms; and a 39% increase in the cost of reinsurance.
- The Board authorized establishment of the Lifetime Benefits Fund to segregate certain fatality claims from workers' compensation injury claims. Fatality claims are basically annuities that are to be paid at a set amount over the lifetime of the recipient. These reserves were discounted based on a percentage rate of 5%. Discounting recognizes that these loss reserves are being invested and will generate investment income. The Pool transferred \$15.3 million in workers' compensation loss reserves (undiscounted) from the Workers' Compensation Fund to the Lifetime Benefits Fund. Adopting discounting resulted in a change of accounting principles and a "cumulative effect of a change in accounting principle" on the statement of revenues, expenses and changes in accumulated members' equity. The reserve discount was determined to be approximately \$6.1 million resulting in a \$9.2 million discounted transfer to the Lifetime Benefits Fund.
- The Pool invests approximately \$397 million primarily in government-backed securities, as stipulated under statutory restrictions mandated by the State of Texas. Income derived from these investments is used to help determine member contribution rates and offset administrative expenses and reinsurance costs. Contributions, administrative expenses, and reinsurance costs are material components of the Pool's operations. Given the nature of the Pool's operations and the integral part investment income plays in those operations, it would be inappropriate for the Pool to exclude investment income from operating activities.

Overview of the Financial Statements

This overview is an introduction to the Pool's financial statements. The Pool's financial statements consist of three components: 1) combined financial statements, 2) notes to the financial statements, and 3) fund financial statements. The fund statements include the Workers' Compensation Fund, Liability Fund, Property Fund, Reinsurance Fund, Stability Fund, Property Improvement Fund, and Lifetime Benefits Fund. Within the Reinsurance Fund is the Large Loss sub-fund. Financial activities and results of these funds are accounted for and presented separately within this report, which also contains supplementary information.

Fund accounting and combined financial statements. The Pool is a local government created by contract and all of the Pool's funds are accounted for and reported as self-sustaining business-like activities. There are three primary operating funds; Workers' Compensation, Liability, and Property. These three funds are allocated administrative expenses on a monthly basis. All member contributions flow into these three funds. The other four operating funds handle specific operational functions, such as reinsurance and large loss coverage through the Reinsurance Fund; unallocated loss adjustment expenses from the Stability Fund; property restoration and improvement due to Highway 183 expansion from the Property Improvement Fund; and specific workers' compensation fatality claims in the Lifetime Benefits Fund. Combining the financial activities and results of all of the individual funds within the combined financial statements summarizes the financial operations of the Texas Municipal League Intergovernmental Risk Pool.

The Balance Sheet presents information regarding all of the Pool's assets and liabilities, with the difference between the two being reported as Accumulated Members' Equity. Over time, increases or decreases in Accumulated Members' Equity may provide a useful indicator regarding how the Pool is meeting the needs and expectations of its members.

The Statement of Revenues, Expenses, and Changes in Accumulated Members' Equity presents the financial results of operations of each individual fund. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Certain inter-fund transactions are eliminated when the individual statements are combined. These eliminations are shown in the combining statements. The combined financial statements present the results of operations for the Pool as a whole. This statement presents information showing how the Pool's Accumulated Members' Equity changed during the most recent fiscal year. All changes in Members' Equity are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., accrued investment income and contract service fees payable.) The basic financial statements begin on page 30.

Annual adopted budget and budgetary controls. Each year the Pool adopts an annual operating budget for each department and fund, and a five-year projected budget for each fund. The preparation of the annual operating budget requires each department manager to provide detailed requests for each budgetary line item. Each line item is reviewed by the Chief Financial Officer and the Executive Director to assure proposed expenditures are consistent with the Pool's objectives and overall mission. After approval by the Executive Director the proposed budget is presented to the Pool's Board of Directors for final review and adoption. Budget expenditures are reviewed on a monthly basis to assure compliance with the adopted budget. The Pool is not under any statutory requirement to produce or adhere to an annual budget. The Board, however, has a mandated policy that the budget cycle must be annual.

	Budget 2001-2002	Actual 2001-2002	Difference	
Contributions	\$90,875,000	\$100,153,305	\$9,278,305	Increase due to rising experience modifiers & growth
Service Fee & Other Income	1,237,000	1,207,316	(29,684)	As budgeted
Investment Income (interest income)	24,500,000	23,821,292	(678,708)	Decrease in interest rates
Total Revenues	<u>116,612,000</u>	<u>125,181,913</u>	<u>8,569,913</u>	
Total loss and loss adjustment expenses	74,250,000	109,156,307	34,906,307	Losses developed substantially higher than expected especially in workers' compensation coverage
Reinsurance Expense	6,151,000	7,938,380	1,787,380	Increase due to 9/11 and tighter market
Contract service fees	4,015,000	3,858,277	(156,723)	As budgeted
Administrative expenses	<u>21,387,000</u>	<u>21,078,926</u>	<u>(308,074)</u>	As budgeted
Total expenses	<u>105,803,000</u>	<u>142,031,890</u>	<u>36,228,890</u>	
Excess of revenues over expenses before investment income (change in market value)	\$10,809,000	\$(16,849,977)	\$(27,658,977)	Due to significant increase in claim losses over the amount originally budgeted
Investment income (change in market value)	0	4,460,430	4,460,430	Includes both realized and unrealized gains
Cumulative effect of accounting change	<u>0</u>	<u>6,157,730</u>	<u>6,157,730</u>	
Excess of revenues over expenses	<u>\$10,809,000</u>	<u>\$ (6,231,817)</u>	<u>\$(17,040,817)</u>	

Notes to the financial statements. The notes provide additional information that is integral to a full understanding of the financial information presented in the combined financial statements. The notes to the financial statements begin on page 34.

Supplemental information. In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information regarding the Pool's ten-year claims development history. Setting member contribution rates today to cover the assumed risk of possible future loss occurrences is largely guided by claim development. Analysis of trends in claims development indicates whether losses are increasing, decreasing or static. Required supplementary information is located on pages 46-49.

Combining Statements. The combining statements are presented immediately following the notes to the financial statements and Supplemental Information. The combining statements show all of the Pool's financial activities on both an individual fund and combined basis. These statements help to point out how each fund has influenced the combined results of operations. The combining statement can be found on pages 50-52.

Financial Analysis for the Pool as a Whole

At \$396.7 million, cash and investments make-up 96.8% of the Pool's total assets. Estimated ultimate unpaid losses and loss adjustment expenses (loss reserves) at \$185.2 million comprise 93.3% of total liabilities. The Pool's investments are restricted to government-backed securities by law and Board policy. The Pool does not practice active market trading. Instead, the Pool utilizes interest income from investments it intends to hold until maturity. From time to time, the Pool may take advantage of the market's volatility to realize gains on certain investments or to re-position investments to maximize future income.

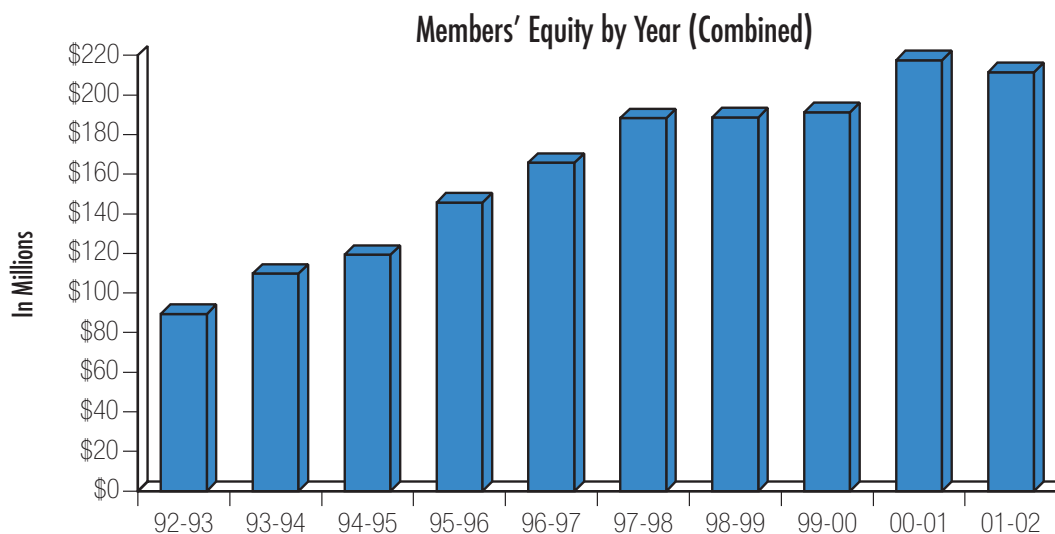
Through various cash management techniques the Pool's investments are staged in such a manner as to cover current cash requirements without having to sell any of the Pool's longer-term investments. This allows the Pool to hold longer-term investments until they mature and to have cash readily available as needed to fund operations.

Texas Municipal League Intergovernmental Risk Pool
Schedule of Combined Accumulated Members' Equity
For the fiscal year ended September 30, 2002

Fixed maturities	\$342,714,274
Short-term investments	19,196,930
Cash and cash equivalents	34,799,601
Receivables and other assets	8,847,595
Capital assets	<u>4,326,480</u>
Total assets	<u>\$409,884,880</u>
Estimated ultimate unpaid losses and loss adjustment expenses	\$185,197,642
Other liabilities	<u>13,325,084</u>
Total liabilities	<u>198,522,726</u>
Accumulated Members' Equity	<u>\$211,362,154</u>

As of September 30, 2002 there were no amounts of Accumulated Members' Equity that the Pool's Board of Directors had declared as restricted and all such funds were determined necessary for Pool operations. At the end of the current fiscal year, the Pool reported positive balances of Accumulated Members' Equity in all seven of its funds.

<u>Accumulated Members' Equity by Fund</u>	<u>9/30/02</u>	<u>9/30/01</u>
Workers' Compensation	\$ 54,168,358	\$ 63,333,844
Liability	82,533,241	80,051,830
Property	13,188,550	17,150,134
Reinsurance	38,314,223	32,437,167
Stability	22,970,878	24,576,647
Property Improvement	144,544	44,349
Lifetime Benefits	<u>42,360</u>	<u>0</u>
Combined Members' Equity	<u>\$211,362,154</u>	<u>\$217,593,971</u>



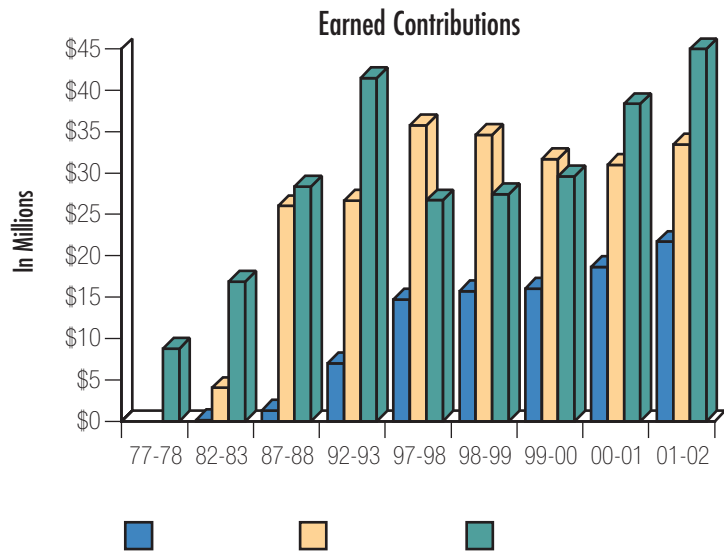
Some of the more important fund transactions during 2001-02 are:

- The Unallocated Loss Adjustment Expense Reserve (ULAE) was transferred to the Stability Fund from the Workers' Compensation, Liability, and Property Funds. ULAE reserves were established to cover administrative expenses for the remaining life of a claim in the event that the Pool ceases to exist. Since the Pool would no longer receive contributions in a particular fund or funds, the ULAE reserves would be used to finance Pool shut down activities. Claim payments and related administrative expenses are often referred to as claim run-off expenses. ULAE reserves are more appropriately reflected in the Stability Fund, and thus the Stability Fund's purpose policy has been appropriately revised.
- The Lifetime Benefits Fund was activated and certain loss reserves were discounted. The cumulative effect of this change in accounting principle has been explained previously in this report.
- Contributions to the Stability Fund from the Workers' Compensation, Liability, and Property Funds were discontinued and a Large Loss sub-fund was established within the Reinsurance Fund to receive payments previously being passed to the Stability Fund. This action allowed the Pool to assume a higher level of risk within the Reinsurance Fund. Contributions previously made to the Stability Fund were discontinued, reestablished at the original 2% of contributions, and placed in the Large Loss sub-fund.
- Implementation of Governmental Accounting Standards Board Statement No. 34 (GASB 34) for financial reporting purposes. The most notable changes can be seen in this Management's Discussion and Analysis section and the format of the Combined Statement of Cash Flows.

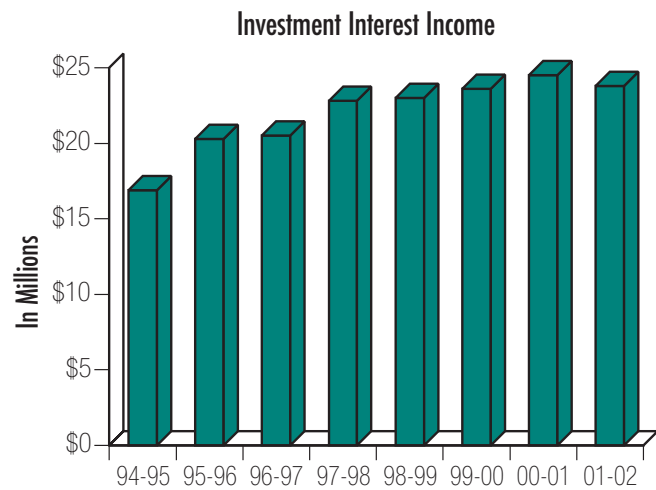
Income and expenses. The majority of the Pool's operating income and expenses are contained within a relatively small number of accounts. Following is a brief description of those accounts.

Contributions. The Pool provides self-insurance to members in much the same way as insurance companies provide insurance protection for customers. Coverages are rated for each individual member based on established rates, adjusted by experience modifiers and discounts to reflect the actual loss experience of the member. The experience modifier is based on prior experience adjusted by certain factors. Member contribution rating is accomplished by the Pool's Underwriting Department which has assigned each member to one of its staff underwriters. Required contribution fees are billed and subsequently collected through the Pool's Finance and Accounting Departments. For the fiscal year ended September 30, 2002 the Pool had reported combined earned contributions of \$100.2 million compared to \$88.0 million in the previous year. The primary reasons for the \$12.2 million increase is a worsening of experience modifiers due to upward trending loss experience, growth in the number of members participating in the Pool, members expanding their coverage options and pass-through rate increases due in large part to a 39% increase in the costs paid to outside reinsurers.

Investment income. Bond interest earnings is the Pool's chief source of investment income. From time to time some gains from the sale of investments may be realized due to the Pool or one of its three contracted investment managers taking advantage of market conditions. The Pool's policy is to hold investments until maturity. The Pool does not engage in the practice of buying or selling investments to produce income from realized gains. The Pool complies with the provisions of GASB 31 by reporting unrealized gains on investments as an income item. The Pool's position is that unrealized gains or losses are not actual funds received or lost and therefore the Pool shows the unrealized gain or loss separately. Market volatility can produce a substantial amount of gain or loss that, if reported as a part of interest income, would distort the actual amount of investment income received and available for fund operations. The Pool earned \$23.8 million in investment (interest) income for 2001-02 which was slightly lower than the \$24.5 million in the previous year. Total investment income including gains or losses from the sale of investments and excluding unrealized gains was \$26.3 million, which was \$1.6 million higher than the previous year. Investment income (change in market value) contains the unrealized portion of the change, any realized gains or losses experienced during the year and amortization of discounts/premiums. The realized gains were \$4.9 million and \$1.8 million for 2001-02 and 2000-01, respectively. Investment interest income was lower because market interest rates decreased during the year.

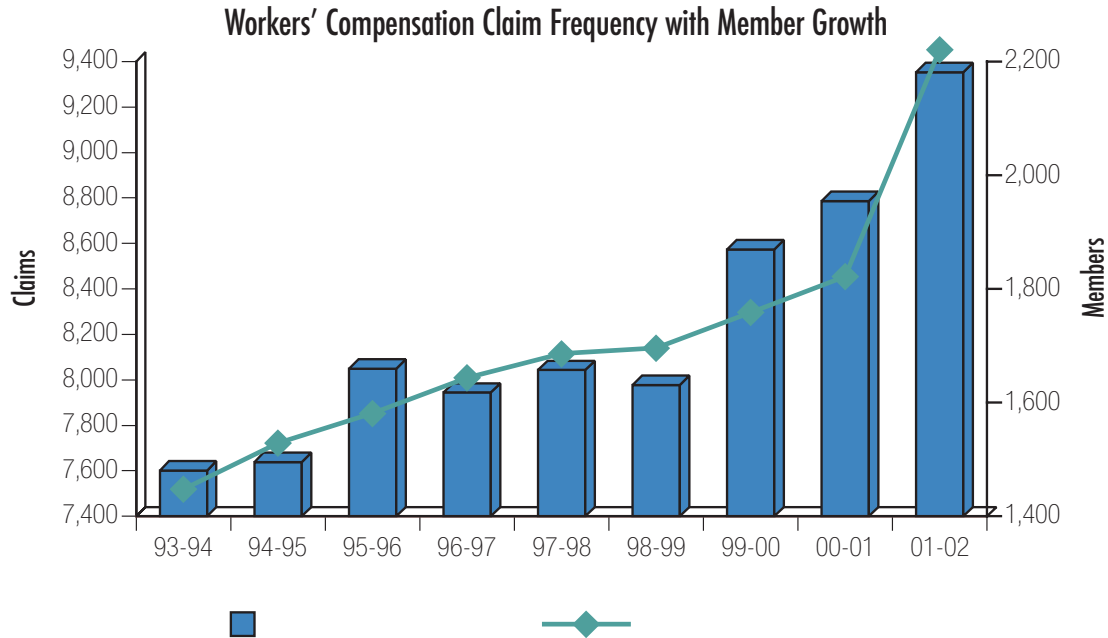


Claim payments and reserves. The Pool processes claims and pays for covered losses experienced by its members. All claims are processed and managed in-house. Outside claims adjusters, attorneys, medical experts, and other professionals are contracted on an as needed basis. Between the time a claim is reported and the time it is resolved, reserves are established for the estimated amount that will have to be paid at some future date to settle the loss. In the Workers' Compensation and Liability Funds, reserves are also established for claims that have occurred, but are not yet known to the Pool. This is known as IBNR (incurred but not yet or under reported) reserves and recognizes losses in the current year for claims that will not be reported until future periods. This process allows a matching of current year contributions with estimated total losses that will be incurred as the result of current fiscal year coverages. Both paid and reserved losses have been increasing over the past several years. In 2001-02 losses were \$30.9 million higher than the \$78.3 million reported in the previous year.



Administrative expenses and contract service fees. In providing coverage and other member services, the Pool incurs administrative expenses and contract service fees. All of these expenses are budgeted and monitored on a monthly basis for compliance with budgetary limits. Over 70% of all administrative expenses are personnel related, such as salaries, wages, and benefits. The remaining 30% pays for office supplies, postage, phone service, utilities, and similar costs. Contract service fees include outside adjuster fees, medical bill review services and contracted claims management software maintenance. Administrative expenses of \$21.1 million increased by 8.6% over the

previous year. An increase in the number of personnel, cost of living adjustments and employee merit increases account for the majority of that increase. Contract service fees of \$3.9 million increased by 5.9% over the previous year due primarily to the increase in the number of claims being processed and referred to outside adjusters and an increase in the number of medical bills being reviewed by the Pool's medical bill review service provider.



Capital Asset and Debt Administration

The Pool's investment in capital assets as of September 30, 2002 was \$4.3 million. This is net of accumulated depreciation and includes the costs associated with the property restoration and improvement project resulting from the Texas Department of Transportation's Highway 183 expansion project. The Pool's investment in capital assets includes land, building, computer systems, vehicles, and office furniture and equipment. The notes to the financial statements contain a more detailed description of the capital assets (fixed assets) and the Pool's capitalization policy. Other than the highway related expansion project just mentioned, the Pool did not have any major capital events during the current or preceding fiscal year.

The Pool had no existing or pending long-term debt financing activities for the current or preceding fiscal year. The Pool could, if needed, secure and utilize debt financing, however, the Pool has not in its 28-year history used debt financing as a means to fund any portion of the Pool's initial or ongoing operations.

Economic Factors

The Pool believes that the 2002-2003 fiscal year should see some easing in the upward trending loss development patterns that the Pool has experienced over the past three to four years. An area of concern that management is monitoring very closely is the cost of reinsurance. Losses incurred by reinsurers from the 9-11 terrorist attacks and the reinsurers loss of investment income have caused reinsurers to significantly increase rates.

The Pool will continue to focus on providing members with training programs of proven loss prevention methods that will help reduce the number and severity of future claims. Operational enhancements that will improve efficiency, reduce costs and/or increase productivity without sacrificing the quality of member services will be pursued.

Investment income should remain strong and contributions should continue to increase as new members are added, existing members expand coverage and the experience modifier - discount rate impact continues. Administrative expenses and contract service fees should see about the same percentage increase as in 2001-2002.

All of these factors were considered in preparing the Pool's budget for 2002-03. As was mentioned earlier, the total amount of Accumulated members' Equity is available to fund Pool operations and no amounts were designated as restricted as of September 30, 2002.

Requests for Information

This financial report is designed to provide a general overview of the Pool's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, Texas Municipal League Intergovernmental Risk Pool, P.O. Box 149194, Austin, Texas 78714-9194.