Policy Type: Administrative

Category: Fiscal and Budget

Sub-Category: General Accounting and Reporting

Policy Name: Self-Insurance Internal Service Fund Policy

Policy Owner: Controller-Treasurer Department

Policy Purpose

The purpose of this policy is to establish criteria for creating an Internal Service Fund (ISF) for County self-insurance activities and provide guidance and procedures for managing County ISFs.

Policy Summary

Internal Service Funds (ISFs) account for the financing of goods and services provided by programs or activities on a cost reimbursement basis. This policy covers self-insurance ISFs at the County including Funds such as Workers' Compensation, Unemployment Insurance, and Liability/Property Insurance.

Self-insurance is the term often used to describe an entity's retention of risk of loss rather than transferring that risk to an independent third party through the purchase of an insurance policy. It is sometimes accompanied by setting aside assets to fund any anticipated losses that may occur under the retained risk.

Two essential elements of any self-insurance decision are:

1. An understanding of the frequency and severity of the risks involved; and
2. The risk-bearing capabilities of the entity in excess of anticipated losses.

Self-Insurance Program

The County is primarily self-insured for its exposure to liability and workers' compensation claims. It monitors and settles all complaints resulting in litigation against the County, and administers the County's self-insured liability/property workers' compensation programs.

A self-insurance program should be operated in a fashion similar to an insurance company, wherein the County sets up reserves as a contingency in case of financial losses. The amount of reserves required is determined by an actuary. Most self-insured entities estimate losses and costs based upon their claims experience and their exposure to loss to determine the amount of reserves.

Self-insurance activities should be fully funded. This means, generally, that a self-insured program should have assets sufficient to meet its potential liabilities, in accordance with the approved range of confidence level indicated in the actuarial report.

Self-Insurance ISF Plan Guidelines

For each County self-insurance internal service fund, the plan shall include:

- the fund balance sheet;
- statement of revenue and expenses including a summary of billing claims paid by department/agency;
- listing of all non-operating transfers into and out of the fund;
- the type(s) of risk(s) covered by the fund (e.g., automobile liability, workers' compensation, etc.); and

- explanation of how the level of fund contributions is determined, including a copy of the current actuarial report (with the actuarial assumptions used) if the contributions are determined on an actuarial basis; and
- a description of the procedures used to charge or allocate fund contributions to County agencies/departments.

Self-insurance ISF Allocation Bases

Self-insurance ISF plans require an effective cost allocation system to formulate contributions. Such cost allocation systems should be:

- equitable, reflecting actual hazards and costs;
- based on easily ascertained and quantifiable data; and
- adjustable for different size deductibles, if units have widely disparate financial size.

Self-insurance ISF Cost Determination

The County will have the following points foremost in mind when developing rates to charge participants in a County self-insurance program. The County must provide the following administrative functions and bear any associated costs:

- the amounts required to maintain each category of reserve at a safe level, using risk analysis through actuarial studies and/or loss reporting systems;
- reserves should be funded through rate charges to users, accumulating over a period of time; and;
- a “premium” should be developed for each self-insurance category (i.e., liability, workers’ compensation, unemployment, etc.) based on:
    - risk-management administrative costs;
    - the costs of excess insurance premiums; and

  - the amounts required to maintain each category of reserve at a safe level; establishing this requires monitoring the actual losses from claims payments and claim accruals, and monitoring payments from, and contributions and/or adjustments to, each reserve by, at a minimum, worksheet analysis;

- other administrative functions, such as those that deal with financial support for salaries, supplies, training space, and other overheads
  - operational costs, including:
    - salary and benefits of ISF Personnel;
    - service and supplies;
    - Allowable Indirect Overhead Costs (department support service costs);
    - legal; and/or
    - loss control programs and safety training.

Self-insurance ISF Risk Prevention

The Risk Management Department will implement programs to actively reduce the County's exposure to risk from accidental loss.

These programs shall include:

- employee safety programs and emergency procedures;
- the development of loss control programs to reduce third party claims; and
- the development of loss reporting systems to highlight areas for further risk reduction efforts.

The Risk Management Department will determine the maximum tolerable level of loss it can financially afford. Losses beyond this point should be recovered through the purchase of excess insurance. Periodically, the insurance market should be evaluated to determine if it is more cost effective to purchase insurance below the maximum self-retention level or to self-insure. Excess insurance will be purchased to provide protection above maximum self-retention level.

Self-insurance ISF Reserve Determination

With a self-insurance program established, the County will develop and monitor reserve accounts for each distinct category of potential loss. If reserve accounts are not established in the County's accounting records for each loss category, supplemental schedules shall be maintained that provide this information.

Reserve accounts or accrued expenses should be:

- established by actuarial studies or through the evaluation of loss histories;
- discounted for payment in future periods; and
- adjusted no less frequently than annually to reflect the most current information.

Reserves for Catastrophic Losses should include a Maximum and Minimum analysis model and in accordance with self-insurance funding policies (Board Policy 4.15):

- **Maximum Level** – A realistic estimate must be developed of the probable maximum losses that the County could incur in a fiscal year. When the probable maximum reserve level is fully cash-funded, charges to users for the reserve should be reduced or suspended until the reserve approaches the minimum level;
- **Minimum Level** – A realistic estimate of the minimum amount the County needs to cover losses as they occur and still provide financial security to the self-insurance program is also required. When the cash balances fall to the minimum reserve level,

reserve charges to users should be re-established or increased to provide additional reserve protection; and

Reserves for Incurred Losses such as: claims settled but not paid, claims reported but not settled, reserve for incurred but not reported losses.

If the reserve exceeds the reserves above the criteria, then the ISF department must provide plans to decrease reserves to acceptable levels. The Controller-Treasurer Department and Office of Budget and Analysis will review the reserve balance analysis submitted by the ISF department and determine compliance with the above criteria.

Self-insurance ISF Annual Review and Adjustment

The rates at which each self-insurance program is charged should be reviewed by the County agencies/departments utilizing an ISF(s) annually, and adjusted when needed to reflect changes in the cost of providing insurance. These reports should include a reconciliation of reserve levels versus loss of payments.

Self-insurance ISF Loans

Loans may be made from insurance funds only to other County funds, subject to the following restrictions:

- the loan is recorded as an amount receivable in the ISF's financial records;
- the loan must be repaid with interest and interest computed at the same rate that the ISF could have earned had the loan not taken place;
    - the period of the loan cannot exceed 36 months;
        - the loan does not impact adversely the ISF's current cash requirements;

- the loan is included in the measurement of the self-insurance fund's assets for actuarial purposes; and
- the loan agreement must include a clause that permits the ISF to demand accelerated repayment of all or any part of the loan if its cash requirements so dictate.

If a loan made by an ISF is not fully paid back by the end of the loan period, the loan is regarded as a bad debt and requires a backfill from the County general fund.

Long-term liabilities (such as bonds, notes, capital leases, pensions, judgments or similar commitments) directly related to, and expected to be paid from, self-insurance ISF funds should be included in the self-insurance ISF fund. These are specific self-insurance fund liabilities. Also, such liabilities may constitute a mortgage or lien on the specific self-insurance fund asset or income.

Decision to Create a Self-Insurance ISF

1) **Departments** must be committed to controlling costs. Self-insurance is a long-term method for funding liabilities. It may take a few years to realize the benefits of self-insurance.

2) The financial feasibility of self-insuring must be examined. For some **departments**, self-insurance may be more costly than a traditional policy.

3) Self-insuring also must fit into the organizational philosophy of the County.

4) **Departments** must consider the various ways in which it is exposed to risk. Some exposures are extremely high risk, and are therefore better handled through the traditional insurance markets.

5) **Departments** should take into consideration the advantages and disadvantages listed as part of Frequently Asked Questions in creating a self-insurance ISF.

6) The creation of a self-insurance ISF should be decided amongst each **department**, the Risk Management Department, the **Controller-Treasurer Department**, and the **Office of Budget Analysis**.

Setting Billing Rates for Self-Insurance ISF

1) **ISF departments** must develop and maintain written procedures for cost accumulation, rate development, and billing.

2) **ISF departments** must develop billing rates that accurately reflect the full cost of providing its services and goods annually in accordance with their written procedures, self-insurance funding policies (Board Policy 4.15), State and Federal guidelines, and generally accepted accounting principles, and these billing rates must include direct and indirect costs including salary and benefits of ISF staff, operational expenses, allowable department indirect costs for other central service departments, and reserve allowances for potential loss.

Procedures

Steps to Establish a Self-Insurance ISF

1) **County Agencies/Departments** must complete a Fund Description Form and a Request for Cost Center Form and submit both forms, via email, to the Controller-Treasurer Department General Accounting Unit [Reporting] if it desires to establish an ISF for Self-insurance.

2) The **Controller-Treasurer Department** and the **Office of Budget and Analysis** will determine whether the creation of an ISF is valid.

Annual Reporting of ISF Rates and Charges

1) **ISF departments** must submit a draft schedule of rates and charges for the upcoming year to the Controller-Treasurer Department and the Office of Budget and Analysis consistent with the Budget Timeline. The **ISF department** must include the total revenues and projected available fund balance which generally must equal or exceed the proposed total expenditures in the proposed budget. A detailed explanation of how the proposed rates and charges were calculated, projected beginning reserves, estimated revenues, and projected costs must be included.

2) **ISF departments** must submit an updated schedule of rates and charges for the upcoming fiscal year consistent with the Budget Timeline.

3) The **Office of Budget and Analysis** will incorporate the updated (mid-March) schedule of rates and charges for the upcoming year in the ISF department's budget as presented by the Recommended Budget. The Final Budget will present the ISF rates and charges adopted by the Board of Supervisors.

4) **ISF department** must submit a final schedule of rates and charges for the upcoming fiscal year consistent with the Budget Timeline.

5) Rates and fees must be reviewed annually by the **ISF department** to determine if any adjustments are needed to address any developing significant surpluses or deficits consistent with the Budget Timeline. This review must compare actual costs of goods and services to the

total costs recovered through existing billing rates and must be submitted to the Controller-Treasurer Department and Office of Budget and Analysis upon completion.

6) The **ISF department** must submit a report of reserve balances as of the end of the prior fiscal year with explanations demonstrating compliance with this policy to the Controller-Treasurer Department and Office of Budget and Analysis consistent with the Budget Timeline.

Required Reserves for Self-Insurance ISFs

1) **ISF departments** must maintain reserves to cover future expenses at confidence levels recommended by actuaries and approved by management and the Board of Supervisors. These reserves, together with any purchased insurance policies, should adequately indemnify the County's risk. Contributions to reserves must be based upon sound actuarial principles using historical experience and reasonable assumptions. Actuarial studies for self-insurance plans should be completed at least once every two years.

2) **ISF departments** must submit reserve balances at the end of the prior fiscal year with explanations demonstrating compliance with the above criteria to the Controller-Treasurer Department General Accounting Unit [Reporting] and the Office of Budget and Analysis consistent with the Budget Timeline.

Definitions

None

Frequently Asked Questions

1) What are examples of self-insurance programs and their allocation bases?

Self-Insurance Program	Allocation Bases
Workers' Compensation	The County uses a five-year loss history with a 70/30 experience/exposure division favoring experience.
General Liability	The County uses a 10-year loss history with an 80/20 experience/exposure division favoring experience.
Automobile Liability	The County uses a 10-year loss history with an 80/20 experience/exposure division favoring experience.
Medical Malpractice	Spread among County healthcare service departments.
Property Loss including Earthquake	The County uses the market value of insured properties, square footage for buildings occupied by more than one department, and actual losses two years prior.

2) What are the advantages and disadvantages of creating a County Self-Insurance ISF?

Advantages

- Increase cost savings – improves ISF organization's operating profit by reducing premium costs. Costs such as overheads for policy administration, assumption of risk and profit are retained by the ISF organization. Avoids premium taxes and residual market loadings which are charged on insurer premiums.

- Flexibility in the plan design, which can often be modified to provide coverage that commercial insurers are unable to provide.
- Improve loss experience – as the ISF organization will be accountable for its own losses. Awareness generated results in loss prevention techniques.
- Increase employee morale and productivity – employers who make their workplace seen as a caring employer.
- Faster loss settlements, resulting in immediately minimizing disruptions to the workplace.
- Enhanced cash flow, improving the bottom line as fewer funds are required to settle claims and administration costs are reduced.
- Transparency in cost of providing services and products and rates are readably available. Responsiveness to changes in demand is enhanced.

Disadvantages

- Exposure to poor loss experience – if the ISF organization continues to show poor results then the cost of the specific and aggregate limit will increase and self-insurance may ultimately become uneconomic.
- ISF organization requires the establishing of administrative procedures, setting up of systems to settle/monitor claims as well as negotiating with other service providers.
- Added complexity in capturing costs and developing rates to be charged, lack of flexibility in adjusting rates, and the potential for accumulating excess reserves are overcharging customers and government grants.

Related Policies

- Fund Policy https://saecommon.sccgov.org/countypolicy/Fund-Policy.pdf

● Self-Insurance Funding Policies – Board Policy 4.15
https://saecommon.sccgov.org/countypolicy/Board-Policy-4.15-Self-Insurance-Funding-Policies.pdf

Related Forms and Information

● Fund Description Form
[url]/sites/forms/controller/ControllerCountywideforms/Fund Request.pdf

● Request for Cost Center Form
[url]
/sites/forms/controller/ControllerCountywideforms/Cost%20Center%20Form.xls

● Office of Budget & Analysis - Budget Timeline
https://sccconnect.sharepoint.com/sites/oba/Budget-Related%20Information/SitePages/budget-process.pdf

● OMB Uniform Grant Guidance – The White House
https://www.whitehouse.gov/omb/grants_docs

● ASMB C-10, Guide for State, Local
https://www.dol.gov/oasam/boc/ASMB_C-10.pdf
Section 4.5.3 Self-Insurance Funds

● Handbook of Cost Plan Procedures for California Counties -
http://www.sco.ca.gov/Files-ARD-Local/manual_costplanhandbook.pdf
Sec: 2250: ISF Loans (Fixed Assets), Sec: 2255: Self-Insurance, Sec: 4270: Rate Development, Sec: 4250 & 4270: Reserve and Rate Development

● State Accounting Standards and Procedures -

http://www.sco.ca.gov/Files-ARD-Local/ASP_Manual.pdf
Sec 22.03 Allocation Bases for Risk Management

Revision History

Date	Changes Made
3/20/2019	Policy updated to remove reference to three self-insured ISFs (Basic Life, Dental Services, and Employee Benefits)
5/25/2017	Policy uploaded. (David Bruno)