

**SELF-INSURERS' SECURITY FUND**

**FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED JUNE 30, 2010 and 2009**

**AND**

**INDEPENDENT AUDITOR'S REPORT**

**SELF-INSURERS' SECURITY FUND**

**FINANCIAL STATEMENTS**

**For the Years Ended June 30, 2010 and 2009**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
Independent Auditor's Report	1
Financial Statements:	
Statement of Financial Position	2
Statement of Activities and Changes in Net Assets	3-4
Statement of Cash Flows	5
Notes to Financial Statements	6-16

**INDEPENDENT AUDITOR'S REPORT**

The Board of Directors of  
Self-Insurers' Security Fund

We have audited the accompanying statements of financial position of Self-Insurers' Security Fund (a nonprofit organization) (the "Fund") as of June 30, 2010 and 2009, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Self-Insurers' Security Fund as of June 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Perry-Smith LLP*

October 7, 2010

**SELF-INSURERS' SECURITY FUND**  
**STATEMENTS OF FINANCIAL POSITION**

**June 30, 2010 and 2009**

	<b>2010</b>	<b>2009</b>
<b>ASSETS</b>		
Cash and cash equivalents (Note 3)	\$ 34,924,693	\$ 30,241,563
Investments (Note 4)	228,523,270	186,030,470
Credit default swaps	6,886,922	9,933,220
Surety bonds, net of allowance for uncollectible bonds of \$3,482,392 and \$4,271,163, as of June 30, 2010 and 2009, respectively (Note 5)	584,490	649,352
Excess insurance receivable	2,945,623	404,532
Interest receivable	1,059,196	1,065,673
Settlement receivable, net of allowance for uncollectible portion of \$2,068,143 (Note 6)	1,400,000	
Other assets	15,389	4,792
Prepaid expenses	5,133	14,544
Property and equipment, net (Note 7)	42,660	62,018
Deferred compensation plan assets (Note 12)	70,298	53,602
Total assets	<b>\$ 276,457,674</b>	<b>\$ 228,459,766</b>
<b>LIABILITIES AND NET ASSETS</b>		
Accounts payable	\$ 730,556	\$ 823,484
Accrued paid time off	92,042	69,996
Residual equity liability, net (Note 8)	4,712,008	4,389,618
Estimated future liabilities for (Note 9):		
Claims	93,343,867	87,795,019
Administration costs	26,702,558	22,318,876
Deferred compensation (Note 12)	70,298	53,602
Total liabilities	125,651,329	115,450,595
Commitments and contingencies (Notes 10 and 11)		
Net assets:		
Temporarily restricted	151,185,080	142,286,414
Unrestricted	(378,735)	(29,277,243)
Net assets	150,806,345	113,009,171
Total liabilities and net assets	<b>\$ 276,457,674</b>	<b>\$ 228,459,766</b>

The accompanying notes are an integral  
part of these financial statements.

**SELF-INSURERS' SECURITY FUND**

**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS**

**For the Years Ended June 30, 2010 and 2009**

	<u>2010</u>		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Revenues:			
Security deposits and recoveries	\$ 11,530,945		\$ 11,530,945
Alternative Security Program assessments (Note 2):			
Default loss fund fee		\$ 23,466,372	23,466,372
Excess liability protection fee		22,503,411	22,503,411
Investment income (loss) (Note 4)		17,136,481	17,136,481
Excess insurance recoveries	3,914,523		3,914,523
Settlement income (Note 6)	3,468,143		3,468,143
Net assets released from restriction (Note 2)	<u>42,829,864</u>	<u>(42,829,864)</u>	
Total revenues	<u>61,743,475</u>	<u>20,276,400</u>	<u>82,019,875</u>
Expenses:			
Program (Note 9):			
Provision for claims	18,953,442		18,953,442
Provision for claims administration costs	<u>7,993,674</u>		<u>7,993,674</u>
Total program expenses	<u>26,947,116</u>		<u>26,947,116</u>
General and administrative	<u>5,897,851</u>		<u>5,897,851</u>
Alternative Security Program (Note 2):			
Financial instruments		10,160,850	10,160,850
Program design and implementation		<u>1,216,884</u>	<u>1,216,884</u>
Total Alternative Security Program expenses		<u>11,377,734</u>	<u>11,377,734</u>
Total expenses	<u>32,844,967</u>	<u>11,377,734</u>	<u>44,222,701</u>
Change in net assets	28,898,508	8,898,666	37,797,174
Net assets, beginning of period	<u>(29,277,243)</u>	<u>142,286,414</u>	<u>113,009,171</u>
Net assets, end of period	<u>\$ (378,735)</u>	<u>\$ 151,185,080</u>	<u>\$ 150,806,345</u>

The accompanying notes are an integral part of these financial statements.

**SELF-INSURERS' SECURITY FUND**

**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS**

(Continued)

**For the Years Ended June 30, 2010 and 2009**

	<b>2009</b>		
	<u><b>Unrestricted</b></u>	<u><b>Temporarily Restricted</b></u>	<u><b>Total</b></u>
Revenues:			
Security deposits and recoveries	\$ 19,054,101		\$ 19,054,101
Alternative Security Program assessments (Note 2):			
Default loss fund fee		\$ 20,703,146	20,703,146
Excess liability protection fee		18,015,421	18,015,421
Investment income (loss) (Note 4)		(11,959,889)	(11,959,889)
Excess insurance recoveries	663,622		663,622
Net assets released from restriction (Note 2)	<u>55,026,000</u>	<u>(55,026,000)</u>	<u>                    </u>
Total revenues	<u>74,743,723</u>	<u>(28,267,322)</u>	<u>46,476,401</u>
Expenses:			
Program (Note 9):			
Provision for claims	54,516,299		54,516,299
Provision for claims administration costs	<u>13,930,840</u>		<u>13,930,840</u>
Total program expenses	<u>68,447,139</u>		<u>68,447,139</u>
General and administrative	<u>7,873,646</u>		<u>7,873,646</u>
Alternative Security Program (Note 2):			
Financial instruments		11,087,000	11,087,000
Program design and implementation		<u>1,391,837</u>	<u>1,391,837</u>
Total Alternative Security Program expenses		<u>12,478,837</u>	<u>12,478,837</u>
Total expenses	<u>76,320,785</u>	<u>12,478,837</u>	<u>88,799,622</u>
Change in net assets	(1,577,062)	(40,746,159)	(42,323,221)
Net assets, beginning of period	<u>(27,700,181)</u>	<u>183,032,573</u>	<u>155,332,392</u>
Net assets, end of period	<u>\$ (29,277,243)</u>	<u>\$ 142,286,414</u>	<u>\$ 113,009,171</u>

The accompanying notes are an integral part of these financial statements.

**SELF-INSURERS' SECURITY FUND**

**STATEMENTS OF CASH FLOWS**

**For the Years Ended June 30, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
Reconciliation of change in net assets to net cash and cash equivalents provided by operating activities:		
Change in net assets	\$ 37,797,174	\$ (42,323,221)
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation expense	30,407	30,643
(Benefit from) provision for uncollectible bonds	(788,771)	1,706,905
Provision for uncollectible settlement receivable	2,068,143	
Net realized (gain) loss on investments	(265,932)	5,723,640
Net unrealized (gain) loss on investments	(9,494,240)	7,899,350
Net unrealized loss on credit default swaps	10,157,913	3,712,799
Decrease (increase):		
Surety bonds receivable	853,633	488,568
Excess insurance receivable	(2,541,091)	28,135
Interest receivable	6,477	162,830
Settlement receivable	(3,468,143)	
Other assets	(27,293)	(2,355)
Prepaid expenses	9,411	(10,650)
Increase (decrease):		
Accounts payable	(92,928)	346,522
Accrued paid time off	22,046	20,415
Residual equity liability, net of amount charged to doubtful accounts	322,390	(476,403)
Claims and administration costs liability	9,932,530	57,820,744
Deferred compensation	<u>16,696</u>	<u>14,568</u>
Net cash and cash equivalents provided by operating activities	<u>44,538,422</u>	<u>35,142,490</u>
Cash flows used in capital and related financing activities:		
Purchase of property and equipment	<u>(11,049)</u>	<u>(12,744)</u>
Cash flows from investing activities:		
Proceeds from sale and maturity of investments	83,105,273	120,395,583
Purchase of investments	(115,837,901)	(127,553,543)
Purchase of credit default swaps	<u>(7,111,615)</u>	<u>(13,646,019)</u>
Net cash and cash equivalents used in investing activities	<u>(39,844,243)</u>	<u>(20,803,979)</u>
Increase in cash and cash equivalents	4,683,130	14,325,767
Cash and cash equivalents, beginning of period	<u>30,241,563</u>	<u>15,915,796</u>
Cash and cash equivalents, end of period	<u>\$ 34,924,693</u>	<u>\$ 30,241,563</u>

The accompanying notes are an integral part of these financial statements.

**SELF-INSURERS' SECURITY FUND**  
**NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization

Self-Insurers' Security Fund ("SISF" or the "Fund") was established by California law under the Labor Code Article 2.5, Section 3744, effective in 1984. SISF is a tax-exempt organization engaged principally in the administration of workers' compensation claims arising from insolvent private entities that are declared by the Department of Industrial Relations (DIR) as in default with respect to their self-insured workers' compensation claims obligations in California. Revenues to SISF consist mainly of (1) assessments against self-insured member entities; (2) the transfer of the proceeds of self-insured security deposits (surety bonds, LOC's, Cash and/or Securities) arising from defaulting member entities; (3) recoveries from excess insurance carriers and old-form surety bonds; (4) investment income; and/or proceeds payable from risk transfer instruments such as credit default obligations (CDO's) or credit default swaps (CDS's).

SISF levies assessments against current and previously self-insured corporations to provide funds to pay for claims costs arising from its defaulted estates as well as for its on-going operations. Current self-insured corporations are subject to unlimited annual assessments. Once an entity leaves self-insurance it is subject to SISF assessments for 36 months from the date its certificate to self-insure is effectively revoked.

The Labor Code allows, subject to the annual approval of the DIR, acceptance of an alternative security deposit system whereby eligible private self-insured entities can collectively secure collateral for security deposits on a pooled basis through payment to SISF rather than on an individual basis.

Net Assets

SISF had net assets of \$150,806,345 and \$113,009,171 as of June 30, 2010 and 2009, respectively. As discussed in Note 2, effective July 1, 2003, SISF established an Alternative Security Program whereby self-insured corporations meeting certain minimum credit quality are assessed annual fees for participation in the ASP in satisfaction of security deposit requirements. The net assets of the ASP are temporarily restricted by California Labor Code 3701.8 until released by the Director of Industrial Relations.

Basis of Accounting

The accounting records of SISF are maintained on the accrual basis of accounting. SISF's net assets are classified as unrestricted and temporarily restricted.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

##### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

##### Reclassifications

Certain reclassifications have been made to the prior year's balances in order to conform with the classifications used in 2010.

##### Cash and Cash Equivalents

SISF considers all money market mutual funds and highly liquid instruments with an original maturity of three months or less to be cash equivalents.

##### Investments

Investments are carried at fair value based on market quotes with corresponding changes in fair value included in the statements of activities and changes in net assets.

##### Credit Default Swaps

SISF purchases credit default swaps on self-insured employers to cover its exposure above portfolio default protection insurance retention limits. Credit default swaps with net fair values totaling \$6,886,922 and \$9,933,220 at June 30, 2010 and 2009, respectively, are included in the statement of financial position. Unrealized losses totaling \$10,160,850 and \$3,712,799 are recorded within financial instruments expense in the statement of activities and changes in net assets for the years ended June 30, 2010 and 2009, respectively. Credit default swaps with net fair values totaling \$2,780,606, \$7,208,520 and \$(3,102,204) mature in 2011, 2012 and 2013, respectively.

##### Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method with useful lives of three to ten years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation is removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Significant renewals and betterment are capitalized.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

##### Security Deposit Revenue

Revenues from surety bonds and deposits are recognized in the financial statements when SISF assumes, as stipulated in the Labor Code, the responsibility to administer the funds necessary to pay workers' compensation obligations against an insolvent self-insurer. SISF initially records revenue in the aggregate amount of (i) cash received from either surety bonds and/or deposits placed by the bankrupt corporation, and (ii) the amount receivable from surety bonds and deposits necessary to pay for estimated future liabilities for claims and administration costs, net of amounts estimated not to be collectable from a surety that is or may become insolvent.

##### Estimated Future Liabilities for Claims and Administration Costs

SISF establishes estimated future liabilities for claims and administration costs based on actuarial estimates of the ultimate cost of claims (including future claims adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. Estimated amounts of subrogation and excess insurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Because actual claims costs depend on such complex factors as inflation, changes in doctrine of legal liability, and claim obligations, the process used in computing estimated future liabilities for claims and administration costs will not result in the exact amount ultimately paid. Estimated future liabilities for claims and administration costs are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect changes in the legal and financial exposures associated with each open claim. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to estimated future liabilities for claims and administration costs are charged or credited to expense in the periods in which the estimates are revised.

SISF records the actuarial estimate of claims liabilities for defaulted self-insured corporations when they become estates of the Fund, as assigned by the DIR.

##### Alternative Security Program

Assessments for the Alternative Security Program (ASP) are recognized as revenue when earned over the coverage period provided. In addition, the costs associated with implementing the ASP are recognized to approximately match the expenses with the related revenues.

##### Income Taxes

Income taxes are not recorded in the accompanying financial statements as SISF has been notified by the Internal Revenue Service that it qualifies as a tax-exempt organization under the Internal Revenue Code Section 501(c)(6). The State of California has notified SISF that it qualifies as a tax-exempt organization under similar provisions of the California Revenue and Taxation Code.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 2. ALTERNATIVE SECURITY PROGRAM

Prior to July 1, 2003, all self-insured corporations were required to post a security deposit, in the form of a surety bond insured by third parties, letters of credit, or cash and/or approved securities. In many cases, these deposits have been inadequate to cover the ultimate liabilities of defaulting estates.

To address this shortfall, an Alternative Security Program (ASP) was established and implemented in July 2003. Under the ASP, self-insured corporations meeting certain minimum credit quality standards (B3/B- or better) are assessed annual fees for participation in the ASP in lieu of posting a security deposit. SISF uses assessments to (i) provide funds for any future defaults of the self-insured employers, and (ii) purchase catastrophe coverage/hedge instruments for certain loss exposures associated with the ASP. Self-insured private entities not eligible under the ASP post their required security deposit with the Office of Self Insurance Plans (OSIP) and pay a portion of the annual assessments, which can be used to fund potential deposit shortfalls. SISF can use any one or combination of the following security instruments specified in the Labor Code to cover the deposit requirements of participating self-insured corporations: (i) cash, (ii) letters of credit, (iii) approved securities, (iv) surety bonds, (v) insurance coverage, or (vi) other financial instruments, such as commercial paper or reinsurance contracts; or financial guarantees, including SISF's own guarantee backed by cash or securities.

For the years ended June 30, 2010 and 2009, self-insured corporations participating in the ASP were assessed fees of \$45,969,783 and \$38,718,567, respectively. Approximately \$19.6 million and \$19.7 million, respectively, were used to arrange for and purchase catastrophe coverage.

Pursuant to 8 CCR section 15220.3(c), the assessed funds are posted by the Security Fund with the Director of the Department of Industrial Relations. Pursuant to that same section, the Director permits the Security Fund to hire its own funds manager and "invest the deposited cash on behalf of the Security Fund outside of the State Treasury," subject to certain restrictions. One such restriction is that "regardless of whether the Director or the Security Fund manages the cash posted, the funds shall remain in the name of the Director as set forth in [CCR section 15220.8(e)] until such time as the Director orders any or all of the funds released to the Security Fund or refunded to the private self insured employers." The Director releases net assets from restriction under the ASP annually based on SISF's projected payments for claims, administrative costs and operating expenses. In July 2009, the Director released \$35,829,864 from restriction. In addition, the Director approved a release of \$7,000,000 from restriction as of June 30, 2010 to account for the amount of claims expenses that exceeded the initial budget proposed in the 2009/10 Implementation Plan. In July 2008, the Director released \$26,470,000 from restriction. In addition, the Director approved a one-time release from restriction as of June 30, 2009 totaling \$28,556,000 in order to account for claims, administrative costs and operating expenses that had not been released from restriction in prior years.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of June 30, 2010 and 2009 consisted of the following:

	2010	2009
Cash in bank	\$ 864,313	\$ 664,192
Money market accounts	34,060,380	29,577,371
	\$ 34,924,693	\$ 30,241,563

Bank balances and money market accounts up to \$250,000 are covered by Federal Depository Insurance. At June 30, 2010, approximately \$674,000 of the bank balances were uninsured.

For money market funds held by a broker who is a member of the Securities Investor Protection Corporation, cash and securities are insured up to \$100,000 and \$500,000, respectively, in the event the brokerage firm goes out of business.

#### 4. INVESTMENTS

Investments at June 30, 2010 and 2009 consisted of the following:

	2010	2009
Federal Government securities	\$ 72,485,715	\$ 45,372,380
Mortgage-backed securities	43,174,322	51,395,232
Taxable fixed-income securities	17,348,662	19,534,498
Equity securities	95,514,571	69,728,360
	\$ 228,523,270	\$ 186,030,470
Unrealized gains (losses)	\$ 9,494,240	\$ (7,899,350)
Realized gains (losses)	265,932	(5,723,640)
Change in fair value	\$ 9,760,172	\$ (13,622,990)

At June 30, 2010, 54 investment securities with fair values totaling approximately \$67,448,000 and unrealized losses totaling approximately \$12,103,000 had been in a continuous loss position for twelve months or more. At June 30, 2009, 75 investment securities with fair values totaling \$61,181,000 and unrealized losses totaling approximately \$14,844,000 had been in a continuous loss position for twelve months or more. Management periodically evaluates each investment security relying primarily on its investment advisors, observation of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities and that the noted decline in fair value is primarily due to interest rate fluctuations and other market factors.

Net investment income totaling \$17,136,481 for the year ended June 30, 2010 is reported net of related expenses of \$823,419. Net investment losses totaling \$11,959,889 for the year ended June 30, 2009 is reported net of related expenses of \$647,775.

**SELF-INSURERS' SECURITY FUND**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**5. BONDS RECEIVABLE AND ALLOWANCE FOR UNCOLLECTIBLE BONDS**

Bonds receivable at June 30, consist of:

	<u>2010</u>	<u>2009</u>
Amounts due on surety bonds and deposits for:		
P-I-E	\$ 675,483	\$ 1,312,803
Lone Star	447,762	481,048
Interpace	136,728	168,304
Moore Dry Dock	23,218	77,146
Western Medical	2,514,478	2,522,680
Fleming Foods	269,213	273,816
Fairchild		<u>84,718</u>
	4,066,882	4,920,515
Allowance for uncollectible bonds	<u>(3,482,392)</u>	<u>(4,271,163)</u>
	<u>\$ 584,490</u>	<u>\$ 649,352</u>

The activity in the allowance for uncollectible bonds for the years ended June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Balance, beginning of year	\$ 4,271,163	\$ -
(Benefit from) provision for uncollectible bonds charged to general and administrative expense	(788,771)	1,706,905
Provision for uncollectible bonds charged to residual equity liability		<u>2,564,258</u>
Balance, end of year	<u>\$ 3,482,392</u>	<u>\$ 4,271,163</u>

**6. SETTLEMENT RECEIVABLE**

In June 2010, SISF entered into a settlement agreement with one of the Fund's estates (the "Debtor") which had filed for bankruptcy. As part of the settlement, the Debtor agreed to pay SISF \$3,468,143, of which \$1,400,000 is secured by real property and personal property of the Debtor. Also as part of the settlement, the secured portion is accompanied by a promissory note with interest-only payments at three percent for the first five years, five percent for the next five years, and all principal and accrued interest due after ten years. The unsecured portion of the settlement will be satisfied pursuant to the terms of the Debtor's plan of reorganization, as confirmed by the Bankruptcy Court. SISF has established a receivable of \$3,468,143 and related allowance of \$2,068,143 because management believes collection of the unsecured portion of the settlement is unlikely.

**SELF-INSURERS' SECURITY FUND**

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**7. PROPERTY AND EQUIPMENT**

Property and equipment at June 30, consist of the following:

	<u>2010</u>	<u>2009</u>
Software	\$ 45,320	\$ 43,834
Furniture and equipment	141,246	131,683
Leasehold improvements	<u>9,469</u>	<u>9,469</u>
	196,035	184,986
Accumulated depreciation	<u>(153,375)</u>	<u>(122,968)</u>
Property and equipment, net	<u>\$ 42,660</u>	<u>\$ 62,018</u>

Depreciation expense totaled \$30,407 and \$30,643 for the years ended June 30, 2010 and 2009 respectively.

**8. RESIDUAL EQUITY LIABILITY**

Proceeds from surety bonds and/or deposits are assets of SISF. However, when all known claims and administration costs related to proceeds from a particular surety bond or deposit of an estate have been paid, any remaining net assets held by SISF under the arrangement (Residual Equity) may be subject to a claim by the surety, the bankrupt estate or the State, unless negotiated otherwise. SISF records a liability for Residual Equity when they assume the estate. At June 30, 2010 and 2009, assets held (cash and cash equivalents and investments) in excess of estimated liabilities for certain bankruptcy cases were \$4,712,008 and \$4,389,618, respectively, which all or a portion thereof may be subject to a claim by a surety or the estate at a future date when all claims and costs have been paid.

**9. ESTIMATED FUTURE LIABILITIES FOR CLAIMS AND ADMINISTRATION COSTS**

As discussed in Note 1, SISF establishes a liability for both reported and unreported insured events. The following represented changes in the aggregate liabilities during the periods ended June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Estimated future liabilities for claims and administration costs, beginning of period	<u>\$ 110,113,895</u>	<u>\$ 52,293,151</u>
Incurred claims and administration costs:		
Provision for claims	18,953,442	54,516,299
Provision for administration costs	<u>7,993,674</u>	<u>13,930,840</u>
Total incurred claims and claim adjustment expenses	<u>26,947,116</u>	<u>68,447,139</u>
Payments:		
Claims	13,404,594	7,455,464
Administration costs	<u>3,609,992</u>	<u>3,170,931</u>
Total payments	<u>17,014,586</u>	<u>10,626,395</u>
Total estimated future liabilities for claims and administration costs	<u>\$ 120,046,425</u>	<u>\$ 110,113,895</u>

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 9. ESTIMATED FUTURE LIABILITIES FOR CLAIMS AND ADMINISTRATION COSTS (Continued)

The components of the estimated future liabilities for claims and administration costs as of June 30, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
Reported claims	\$ 60,850,864	\$ 51,334,694
Claims incurred but not reported	32,493,003	36,460,325
Administration costs	<u>26,702,558</u>	<u>22,318,876</u>
	<u>\$ 120,046,425</u>	<u>\$ 110,113,895</u>

#### 10. COMMITMENTS AND CONTINGENCIES

##### Line of Credit

SISF maintains a line of credit with a total available balance of \$100 million. A commitment fee of 1% per annum is payable quarterly on the unused portion of the available balance. The line is secured by SISF cash and marketable securities and has been established for short-term liquidity needs. No funds have been drawn on this line of credit as of June 30, 2010 or 2009.

##### Administration Contracts

SISF contracts for the conceptual design and arrangement of various hedging instruments of the Alternative Security Program. In addition, service providers assist in developing, administering and monitoring an on-going member entity credit rating process and associated procedures.

##### Contingencies

The Fund is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the Fund's financial position or results of operations.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 11. OPERATING LEASE

SISF leases office space under an operating lease with a term ending September 30, 2015. Future minimum lease payments are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 67,450
2012	72,303
2013	73,578
2014	74,853
2015	76,128
Thereafter	<u>15,938</u>
	<u>\$ 380,250</u>

Total rent expense was \$55,378 and \$53,070 for the years ended June 30, 2010 and 2009, respectively.

#### 12. EMPLOYEE RETIREMENT PLAN

SISF established a deferred compensation plan pursuant to Internal Revenue Code Section 457(b) primarily for the purpose of providing deferred compensation for a select group of management. Employees may elect to defer a portion of their salary each year. Eligible participants are credited with income and gains and charged with losses, expenses and distributions based upon investment selections made by the employees. As of June 30, 2010 and 2009, there was one employee participating in the plan. Deferred compensation plan assets totaling \$70,298 and \$53,602 at June 30, 2010 and 2009, respectively, consist of cash, fixed income investments and mutual funds reserved for future payment of deferred compensation liabilities. There are no employer contribution expenses associated with this plan because all contributions are made by employees.

SISF also adopted a contributory 401(k) Plan effective August 1, 2005. The Plan is available to all employees who have completed one month or 30 days of service and are at least 21 years of age. Under the Plan, employees can elect to defer a selected portion of their annual compensation and SISF may match each employee contribution in an amount to be determined annually by the Board of Directors. For the years ended June 30, 2010 and 2009, SISF contributed \$19,791 and \$18,411, respectively.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 13. FAIR VALUE MEASUREMENTS

##### Fair Value of Financial Instruments

The estimated fair values of SISF's financial instruments are as follows:

	June 30, 2010		June 30, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 34,924,693	\$ 34,924,693	\$ 30,241,563	\$ 30,241,563
Investments	228,523,270	228,523,270	186,030,470	186,030,470
Credit default swaps	6,254,805	6,254,805	9,933,220	9,933,220
Bonds receivable, net	584,490	584,490	649,352	649,352
Excess insurance receivable	2,945,623	2,945,623	404,532	404,532
Interest receivable	1,059,196	1,059,196	1,065,673	1,065,673
Plan assets – deferred compensation	70,298	70,298	53,602	53,602
Financial liabilities:				
Accounts payable	\$ 730,556	\$ 730,556	\$ 997,409	\$ 997,409
Deferred compensation	70,298	70,298	53,602	53,602

These estimates do not reflect any premium or discount that could result from offering SISF's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, bonds receivable, excess insurance receivable, interest receivable, deferred compensation plan assets, accounts payable and deferred compensation, the carrying amount is estimated to be fair value. For investments fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. For credit default swaps, fair values are based on quoted market prices from the counterparties for the credit defaults swaps.

##### Fair Value Hierarchy

In accordance with ASC 820-10, SISF groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

## SELF-INSURERS' SECURITY FUND

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 13. FAIR VALUE MEASUREMENTS (Continued)

##### Fair Value Hierarchy (Continued)

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect SISF's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

##### Assets Recorded at Fair Value

The following table presents information about SISF's assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 and 2009. There were no assets or liabilities measured at fair value on a non-recurring basis at June 30, 2010 or 2009.

SISF is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>June 30, 2010</u>				
Investments	\$ 228,523,283	\$ 95,514,571	\$ 133,008,712	
Credit default swaps	6,254,805		6,254,805	
	<u>\$ 234,778,088</u>	<u>\$ 95,514,571</u>	<u>\$ 139,263,517</u>	<u>\$ -</u>
<u>June 30, 2009</u>				
Investments	\$ 186,030,470	\$ 69,728,360	\$ 116,302,110	
Credit default swaps	9,933,220		9,933,220	
	<u>\$ 195,963,690</u>	<u>\$ 69,728,360</u>	<u>\$ 126,235,330</u>	<u>\$ -</u>

Fair values for investment securities, which include debt securities of U.S. Governmental agencies, mortgage-backed securities, fixed income securities and equity securities are based on quoted market prices for identical or similar securities. Fair values for credit default swaps are based on quoted market prices from the counterparties.

#### 14. SUBSEQUENT EVENTS

Management has reviewed events occurring through October 7, 2010, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.