

**MERCANTILE SELF-INSURANCE TRUST**

**FINANCIAL STATEMENTS**

**December 31, 2012**

## **INDEPENDENT AUDITORS' REPORT**

New York State Workers' Compensation Board  
Mercantile Self-Insurance Trust

We have audited the accompanying balance sheet of Mercantile Self-Insurance Trust (the Trust) as of December 31, 2012, and the related statements of income and changes in accumulated deficit, and cash flows for the year 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 accounting principles generally accepted in the United States of America; this includes 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 audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Trust'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 Trust'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 the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Basis for Qualified Opinion**

We were unable to obtain confirmation of the contributions receivable balance totaling \$646,505 at December 31, 2012 by direct correspondence with the members. We were unable to satisfy ourselves as to the balance by means of other auditing procedures.

## Qualified Opinion

In our opinion, except for the possible effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Trust as of December 31, 2012 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Lumden & McCormick, LLP*

January 8, 2014

MERCANTILE SELF-INSURANCE TRUST

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**Balance Sheet**

December 31, 2012

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**Assets:**

Cash	\$ 2,526,938
Contributions receivable	646,505
Special assessments receivable, net (Note 2)	295,470
Second injury fund receivable (Note 3)	424,067
Reinsurance recoverable (Note 1)	2,106,054
Prepaid expenses	16,267
Prepaid income taxes	12,460
Deferred income taxes	5,798,500
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	\$ 11,826,261

**Liabilities and Members' Equity**

**Liabilities:**

Unpaid losses and loss adjustment expenses:	
Case-basis reserves (Note 4)	\$ 8,884,509
Incurred but not reported (Note 4)	7,128,637
Unallocated loss adjustment expenses (Note 4)	1,804,085
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	17,817,231
Accounts payable and accrued expenses	74,318
Workers' Compensation Board assessments payable - current	104,825
Workers' Compensation Board assessments payable - prior incurred	2,185,327
Accrued Workers' Compensation Board assessments	832,684
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	21,014,385

**Members' equity:**

Accumulated deficit	<hr/>
	(9,188,124)
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	\$ 11,826,261

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MERCANTILE SELF-INSURANCE TRUST

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**Statement of Income and Changes in Accumulated Deficit**

For the year ended December 31, 2012

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Revenues:	
Deficit assessments	\$ 2,303,068
Investment income	92,161
	<u>2,395,229</u>
Expenses:	
Incurred losses and loss adjustment (Note 4)	4,257,349
Workers' Compensation Board assessments	(639,642)
Legal, management, and other professional fees	204,845
Bad debts	1,038,971
Miscellaneous	34,733
	<u>4,896,256</u>
<b>Loss before income taxes</b>	<b>(2,501,027)</b>
Provision for income taxes (benefit) (Note 5)	<u>(5,798,800)</u>
<b>Net income</b>	<b>3,297,773</b>
Accumulated deficit - beginning	<u>(12,485,897)</u>
Accumulated deficit - ending	<u>\$ (9,188,124)</u>

*See accompanying notes.*

MERCANTILE SELF-INSURANCE TRUST

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**Statement of Cash Flows**

For the year ended December 31, 2012

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**Operating activities:**

Net income	\$ 3,297,773
Adjustments to reconcile net income to net cash flows from operating activities:	
Net gain on sale of investments	69,077
Deferred income taxes	(5,798,500)
Bad debts expense	1,038,971
Changes in other operating assets and liabilities:	
Contributions and special assessments receivable, net	(1,535,824)
Second injury fund receivable	746,436
Reinsurance recoverable	1,505,946
Prepaid expenses	(7,927)
Unpaid losses and loss adjustment expenses	1,880,231
Accounts payable and accrued expenses	(30,179)
Workers' Compensation Board assessments payable	97,416
Accrued Workers' Compensation Board assessments	(737,058)

**Net operating activities** 526,362

**Investing activities:**

Purchase of investments	(1,413,561)
Proceeds from investments sold	2,162,285

**Net investing activities** 748,724

Net change in cash 1,275,086

Cash - beginning (includes restricted cash) 1,251,852

Cash - ending \$ 2,526,938

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Supplemental cash flows information:

Income taxes paid	<u>\$ -</u>
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**Notes to Financial Statements**

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**1. Summary of Significant Accounting Policies:**

**Organization:**

Mercantile Self-Insurance Trust (the Trust) is a self-insurance trust established in 1994. Its member employers were primarily engaged in the retail distribution and/or sale of food products in the State of New York. The Trust provided workers' compensation insurance for employees of its members through February 29, 2008. The Trust is not responsible for any claim obligations incurred by its members prior to entering the Trust.

The Trust is currently in run-off status. When the forensic accounting procedures are completed, a deficit assessment will be issued by the New York State Workers' Compensation Board (the WCB) to all members. Payments for future claims and administrative expenses will be made from Trust funds held by the WCB, advances from WCB assessment account funds, and from member payments on the future WCB issued deficit assessment billing.

The Trust is currently administered by NCAComp, Inc., an unrelated organization hired by the WCB to provide third party administrative services. In accordance with the Trust agreement, participants are responsible for deficits.

Pursuant to title 12 of New York State Codes, Rules and Regulations Section 317.20, the WCB determined the financial stability of the Trust could not be restored in a timely and appropriate manner, and accordingly, on June 1, 2012, initiated steps for the future dissolution of the Trust. The WCB has effectively assumed the responsibility for all administrative duties of the Trust, including the payment of claims for accidents incurred through February 29, 2008. In the event the Trust's assets are inadequate to fund future operations, the WCB is required to fund future remaining claims and related obligations of the Trust.

**Subsequent Events:**

The Trust has evaluated events and transactions for potential recognition or disclosure in the financial statements through January 8, 2014 (the date the financial statements were available to be issued).

**Cash:**

Cash in financial institutions may exceed insured limits at various times during the year and subject the Trust to concentrations of credit risk.

**Contributions Receivable:**

Contributions receivable represent amounts applicable to periods through February 29, 2008. Contributions are written off when they are determined to be uncollectible. If deemed necessary, an allowance for doubtful accounts is estimated based on the WCB's ability to enforce and pursue collection. The WCB believes no allowance for doubtful accounts is necessary at December 31, 2012.

**Special Assessments Receivable:**

Special assessments receivable represent remaining balances on amounts assessed to members prior to June 1, 2012. Management provides for probable uncollectible amounts through a charge to earnings and a credit to allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances still outstanding after management has used reasonable collection efforts are removed through a charge to allowance for doubtful accounts and a credit to special assessments receivable.

**Unpaid Losses and Loss Adjustment Expense:**

Unpaid losses and loss adjustment expenses represent estimates of ultimate future payments to be made to settle all insurance claims for reported losses and estimates of incurred but not reported losses including both allocated and unallocated loss adjustment expenses. These unpaid losses have been determined in consultation with independent consulting actuaries and are based on industry experience and trends. However, such estimates may be more or less than the amount ultimately paid when the claims are settled. Changes in the estimated liability are charged or credited to operations as the estimates are revised.

Management believes the liability for unpaid losses and loss adjustment expense is adequate to cover the ultimate cost of claims incurred through February 29, 2008.

Litigation costs with respect to claims arising from insurance coverages are considered in establishing the estimated liability for unpaid losses and loss adjustment expenses.

### **Reinsurance:**

The Trust reinsured certain portions of its liability to limit the amount of individual losses. The liability of the Trust is limited on an individual loss basis to the first \$300,000 per occurrence for accidents occurring from October 1, 1994 through September 30, 1999, \$350,000 for accidents occurring from October 1, 1999 through September 30, 2001, and \$400,000 for accidents occurring from October 1, 2001 through February 29, 2008.

Total excess claims occurring from January 1, 2004 through February 28, 2006 were subject to a corridor deductible in the amount of \$1,200,000 for accidents occurring January 1, 2004 through December 31, 2004, and \$1,600,000 for accidents occurring January 1, 2005 through February 28, 2006.

Insurance ceded by the Trust does not relieve the Trust of its primary liability for claims. Accordingly, a contingent liability exists with respect to reinsurance which would become an actual liability in the event the reinsuring company might be unable to meet its obligations to the Trust under existing reinsurance agreements.

At December 31, 2012, the liability for unpaid losses and loss adjustment expense was not reduced as a result of insurance ceded.

Recoverable incurred losses and loss adjustment expenses under the reinsurance contracts totaled \$2,106,054 as of December 31, 2012. This amount is presented as an asset on the accompanying balance sheet.

### **Workers' Compensation Board Assessments:**

In April 2011, the New York State Governor enacted legislation that reduced WCB assessments due from insolvent and inactive trusts. Specifically, the new legislation eliminated assessments for 151, 15-8, 25-A and IDP for periods subsequent to December 31, 2010. However, the amendments to the law did not eliminate the self-insurance assessment pursuant to Section 50-5 of the Workers' Compensation Law.

In October 2012, the WCB reduced the 50-5 assessment rate charged to insolvent and inactive trusts. This reduction from 10.1% to 5.2% was because the WCB calculated a decrease in the projected cash needs of the 50-5 fund. Therefore, the Trust has calculated the WCB assessment liability at 5.2% of the estimated loss and allocated loss adjustment expenses as of December 31, 2012 in addition to unbilled amounts the Trust owes through December 31, 2012.

This liability is comprised of three components on the accompanying balance sheet: Workers' Compensation Board assessments payable – current (liability related to activity subsequent to the 2010 assessment cycle), Workers' Compensation Board assessments payable – prior incurred (liability related to activity through the 2010 assessment cycle), and accrued Workers' Compensation Board assessments.

### **Income Taxes:**

The Trust provides currently for income taxes applicable to all items included in the financial statements, regardless of when such taxes are payable. Deferred assets and liabilities are recognized for the expected future tax consequences of temporary differences between the tax and financial statement bases of assets and liabilities. Temporary differences arise from using different methods of accounting for bad debts, New York State Workers' Compensation Board assessments, and incurred losses and loss adjustment expenses. Additionally, the Trust recognizes future tax benefits of net operating loss carryforwards to the extent that realization of such benefits is more likely than not. The Trust believes it is no longer subject to examination by Federal and State taxing authorities for years prior to fiscal year ended December 31, 2010.

### **Use of Estimates:**

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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.



## 2. Special Assessments Receivable:

Special assessments receivable	\$ 5,734,470
Less allowance for doubtful accounts	<u>5,439,000</u>
	<u>\$ 295,470</u>

## 3. Second Injury Fund Receivable:

When an eligible claim is approved under New York State's second injury fund (Section 15-8), the Trust is reimbursed for additional losses for previously injured employees. At December 31, 2012, amounts submitted for reimbursement and yet to be repaid by New York State to the Trust on paid losses eligible for reimbursement under the second injury fund totaled \$424,067.

## 4. Unpaid Losses and Loss Adjustment Expenses:

Balance - beginning of year	\$ 15,937,000
Less reinsurance recoverable	<u>3,612,000</u>
Net balance - beginning of year	<u>12,325,000</u>
Incurred related to:	
Current year	-
Prior years	<u>4,257,349</u>
	<u>4,257,349</u>
Net paid related to:	
Current year	-
Prior years	<u>(871,172)</u>
	<u>(871,172)</u>
Net balance - end of year	15,711,177
Add reinsurance recoverable	<u>2,106,054</u>
Balance - end of year	<u>\$ 17,817,231</u>

The case-basis reserves, incurred but not reported, and unallocated loss adjustment expenses components of unpaid losses and loss adjustment expenses are:

Case-basis reserves	\$ 8,884,509
Incurred but not reported	7,128,637
Unallocated loss adjustment expenses	<u>1,804,085</u>
	<u>\$ 17,817,231</u>
Net paid consists of:	
Total paid during the year	\$ 871,172
Less proceeds received on reinsurance claims	-
	<u>\$ 871,172</u>

## 5. Income Taxes:

Current provision (benefit):	
Federal	\$ -
State	<u>(300)</u>
	<u>(300)</u>
Deferred provision (benefit):	
Federal	(791,100)
State	(177,900)
Valuation allowance adjustment	<u>(4,829,500)</u>
	<u>(5,798,500)</u>
	<u>\$ (5,798,800)</u>

The Trust's effective tax rate varies from the statutory federal tax rate primarily as a result of graduated tax rates, state taxes net of federal benefits, and valuation allowance adjustments relative to estimated tax benefits for available net operating loss carryforwards.

Deferred income taxes on the balance sheet at December 31, 2012 consist entirely of assets.

At December 31, 2012, the Trust has approximately \$11,931,000 of federal and state net operating loss carryforwards for income tax reporting purposes. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2032.

Realization of net operating loss carryforwards is dependent upon generating sufficient future taxable income in the jurisdictions where the losses originated. Management has recorded a valuation allowance on a portion of the deferred tax asset related to these net operating loss carryforwards. The amount of the deferred tax asset considered to be realizable could be adjusted based on estimates of future taxable income.

## 6. Contingencies:

The Trust provided employer liability insurance to its members. At December 31, 2012, the Trust is not aware of any asserted or pending claims against any of its members.