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**LOUISIANA INSURANCE GUARANTY ASSOCIATION**

**FINANCIAL STATEMENTS**

**(Cash Basis)**

**YEARS ENDED DECEMBER 31, 2003 AND 2002**

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Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date 4.7.04



LOUISIANA INSURANCE GUARANTY ASSOCIATION

FINANCIAL STATEMENTS

(Cash Basis)

YEARS ENDED DECEMBER 31, 2003 AND 2002



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**Postlethwaite & Netterville**

A Professional Accounting Corporation  
Associated Offices in Principal Cities of the United States  
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**Independent Auditors' Report**

Members and Directors  
Louisiana Insurance Guaranty Association  
Baton Rouge, Louisiana

We have audited the accompanying statement of financial position arising from cash transactions of Louisiana Insurance Guaranty Association as of December 31, 2003, and the related statements of activities for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Association as of December 31, 2002, were audited by other auditors, whose opinion dated March 12, 2003, on those statements was qualified because of the departure from accounting principles generally accepted in the United States of America described in the third paragraph.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audit provides a reasonable basis for our opinion.

As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Louisiana Insurance Guaranty Association as of December 31, 2003 and its changes in net assets during the year then ended, on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2004 on our consideration of the Louisiana Insurance Guaranty Association's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Since these financial statements are prepared on a cash basis, no liability is recorded for future payments for return of unearned premiums or claims. However, as discussed in Note 7 to the financial statements, the Association regularly estimates liabilities for such losses. These estimated losses have not been audited by us and accordingly we express no opinion or any other form of assurance on them.

*Postlethwaite & Netterville*

Baton Rouge, Louisiana  
March 4, 2004

**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**STATEMENTS OF FINANCIAL POSITION**  
**ARISING FROM CASH TRANSACTIONS**  
**DECEMBER 31, 2003 AND 2002**

	<b><u>ASSETS</u></b>	
	<u>2003</u>	<u>2002</u>
Cash	\$ 1,718,882	\$ -
Investments	130,233,603	100,529,307
Building	<u>-</u>	<u>810,161</u>
	<u>\$ 131,952,485</u>	<u>\$ 101,339,468</u>

**LIABILITIES AND NET ASSETS**

Outstanding checks in excess of bank balances	\$ 1,811,943	\$ 1,230,406
Net Assets	<u>130,140,542</u>	<u>100,109,062</u>
	<u>\$ 131,952,485</u>	<u>\$ 101,339,468</u>

The accompanying notes are an integral part of these statements.



**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**STATEMENTS OF ACTIVITIES**  
**FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002**

	2003	2002
<b><u>RECEIPTS</u></b>		
Assessments	\$ 49,297,777	\$ 46,309,948
Distributions from liquidators	11,557,971	6,651,919
Interest income	6,153,363	4,768,083
Net loss on sales of investments	(2,381,868)	(308,237)
Restitutions	34,188	21,267
	64,661,431	57,442,980
<b><u>DISBURSEMENTS</u></b>		
Claims paid	22,394,864	23,254,370
Unearned premiums paid	386,171	651,373
Legal fees and expenses	7,242,064	5,797,355
Claims handling costs	2,466,811	3,049,493
Professional and bank fees	254,948	344,685
Staff salaries, taxes, and benefits	291,977	319,466
Travel, meetings, and seminars	17,868	14,280
Building and renovations	1,165,844	-
Administrative expenses	409,404	248,314
	34,629,951	33,679,336
<b><u>EXCESS OF RECEIPTS OVER DISBURSEMENTS</u></b>	30,031,480	23,763,644
Net Assets - beginning of the year	100,109,062	76,345,418
Net Assets - end of the year	\$ 130,140,542	\$ 100,109,062

The accompanying notes are an integral part of these statements.

**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**NOTES TO FINANCIAL STATEMENTS**

**1. Significant Accounting Policies**

**Organization**

The Louisiana Insurance Guaranty Association (the Association) is an organization created by the Louisiana Insurance Guaranty Act to pay for the claims against insolvent member insurance companies. Funds are provided for the payment of the claims by the assessment of the remaining member insurance companies. All admitted insurance companies doing business in Louisiana except those writing life, health and accident, title, disability, mortgage guaranty, and ocean marine insurance as well as all types of reinsurance, are required to be members of the Association.

The Association's day-to-day operations and management are performed by the Association's staff under the direction of the Board of Directors. The Association also contracts with outside staffing services, claims service providers, and other professionals to carry out these functions.

**Accounting Method**

The Association's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, revenue and related assets are recognized when received, and expenses and related liabilities are recognized when paid. Accordingly, no liabilities are recorded for future payments for unearned premiums, loss claims or related expenses. As discussed in Note 7, the Association regularly estimates amounts for such liabilities.

**Equipment and facilities**

The Association recognizes equipment and facilities as cash disbursements when incurred. These items are not capitalized and depreciated under the Association's cash basis of accounting.

**Income Taxes**

The Association is exempt from income taxes under Internal Revenue Code Section 501(c)(6); therefore, no provision for income taxes has been made.

**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**NOTES TO FINANCIAL STATEMENTS**

**2. Investments**

The Association's investments are recorded at cost and consisted of the following at December 31, 2003 and 2002:

	<u>2003</u>		<u>2002</u>	
	<u>Cost</u>	<u>Estimated Fair Value</u>	<u>Cost</u>	<u>Estimated Fair Value</u>
U.S. Government securities under agreement to sell	\$ 2,685,995	\$ 2,685,995	\$ 3,842,533	\$ 3,842,533
Money market accounts invested in U.S. Treasury obligations	3,937,770	3,937,770	802,008	802,008
U.S. Treasury notes and bonds	39,856,164	39,572,074	38,458,819	37,309,842
U.S. Government Agency obligations	<u>83,753,674</u>	<u>83,770,406</u>	<u>57,425,947</u>	<u>59,237,166</u>
	<u>\$130,233,603</u>	<u>\$129,966,245</u>	<u>\$100,529,307</u>	<u>\$ 101,191,549</u>

The Association's policy is to purchase securities issued by the U.S. Treasury and obligations issued or guaranteed by the U.S. Government and its Agencies. The estimated fair value of these securities is based on quoted market prices. The Association enters into short-term repurchase agreements with Louisiana financial institutions whereby the Association purchases U.S. Government securities with an agreement to resell the securities to the financial institution at cost. The Association also deposits funds in money market funds invested in U.S. Treasury obligations.

The Association purchases securities at premiums or discounts from the contractual maturity amount of the security. Due to the use of the cash basis of accounting, these premiums and discounts are not amortized over the holding period of the security. Instead, these differences are reported as gains or losses upon maturity or sale of the respective security. Accordingly, interest income reflects the contractual interest payments required under the investment securities.

**3. Restricted Net Assets**

Net assets represent funds collected from member insurance companies, distributions from liquidators, interest income, and other receipts in excess of funds disbursed to pay claims and expenses of the Association. All assets are considered restricted under the Act creating the Association. Excess funds are to be used for the payment of claims, return of unearned premiums and reimbursement of expenses incurred for the insolvent member insurance companies (See Note 7).



**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**NOTES TO FINANCIAL STATEMENTS**

**4. Assessments**

Louisiana Revised Statute 22:1382 gives the Association the authority to assess member insurance companies the amount necessary to pay the obligations and expenses of the Association. Beginning January 1, 1990, and ending December 31, 2002, the assessment to member insurance companies cannot exceed an amount equal to two percent (2%) of net direct written premiums during the preceding calendar year. Beginning January 1, 2003, and thereafter, the assessment to member insurance companies is not to exceed an amount equal to one percent (1%) of net direct written premiums during the preceding calendar year, unless changed by the Louisiana Legislature.

The Association has determined that six member companies qualify for earned credits of up to 80% of their annual assessments. Member companies can also qualify for assessment reductions by investing in qualifying Louisiana securities.

**5. Early Access Distributions by Liquidators**

The Association files claims against the estates of insolvent insurers in an effort to recover a portion of the policyholder claims paid and related expenses from the assets of the insolvent insurer. During the years ended December 31, 2003 and 2002, the Association received \$11,557,971 and \$6,651,919, respectively, of such distributions which are reflected as receipts in these financial statements. No estimate is available of future potential distributions from liquidations due to the uncertainty and difficulty in accurately estimating these amounts.

**6. Building**

On December 3, 2002, the Association purchased land and a building in Baton Rouge, Louisiana to be used as a new headquarter site. The building underwent renovations and was occupied and placed into service during 2003. The cost of the building and related improvements were reflected as building expenditures during 2003 as a result of the building being put into use.

**7. Estimate of Future Return of Unearned Premiums and Claims Payments (Not Audited)**

The funds of the Association are used to pay insurance claims of insolvent member insurance companies (See Note 3). These claims are pursuant to the Louisiana Insurance Guaranty Law, La. R.S. 22:1375-1394. As of December 31, 2003, the Association had 4,471 open claims files outstanding, a substantial portion of which are involved in litigation. The Association is also in the process of identifying and quantifying recent insolvencies for which estimated claims liability information is considered uncertain and or incomplete. Additionally, other member insurance companies may be declared insolvent subsequent to the date of these financial statements.

Due to the uncertainty involved in accepting and administering insolvent companies, as well as the difficulty in determining reliable estimates, the Association maintains its financial records on a cash basis. However, the Association regularly attempts to estimate the amount of claims and claims administration expenses related to insolvent member insurance companies. This "reserve setting" practice is a common function of managing and administering those losses.

**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**NOTES TO FINANCIAL STATEMENTS**

7. **Estimate of Future Return of Unearned Premiums and Claims Payments** (Not Audited) (continued)

Provided below is an unaudited condensed balance sheet of the Association at December 31, 2003, on a modified accrual basis which recognizes management's estimate of claims and related liabilities. This information is intended to reflect only certain estimated assets and liabilities of the Association and is not intended to represent the financial position of the Association in accordance with accounting principles generally accepted in the United States of America. These estimates are expected to vary as additional information becomes available.

The condensed unaudited balance sheet does not provide for accruals of amounts due from liquidators of insolvent insurance companies, billed but uncollected member assessments due, adjustments of investments to estimated fair value, and accruals of operating costs owed at year end not included in the reserves for claims administration expenses.

As described in Note 4, the Association has been granted the authority to assess member insurers at a rate of one percent (1%) beginning January 1, 2003, which, if assessed, is expected to produce approximately \$50 million annually. Additionally, La. R.S. 22:1382 provides that if the maximum assessment and other assets available to the Association are insufficient to make all necessary payments, the Association may borrow additional funds or payments can be reduced on a prorated basis and unpaid balances are to be paid as funds become available.

<u>ASSETS</u>		December 31, 2003
		<u>Unaudited</u>
Cash		\$ 1,718,882
Investments, at cost		<u>130,233,603</u>
Total assets		<u>\$ 131,952,485</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Outstanding checks in excess of bank balances		\$ 1,811,943
Estimated claims and claims administration expenses payable		<u>1,093,501,973</u> (1)
Total liabilities		1,095,313,916
Net assets (deficit)		<u>( 963,361,431)</u> (2)
Total liabilities and net assets		<u>\$ 131,952,485</u>

(1) Represents management's estimate of claims and claims administration expense reserves related to open claim files at December 31, 2003.



**LOUISIANA INSURANCE GUARANTY ASSOCIATION**  
**BATON ROUGE, LOUISIANA**

**NOTES TO FINANCIAL STATEMENTS**

7. **Estimate of Future Return of Unearned Premiums and Claims Payments** (Not Audited) (continued)

The Association has been notified of claims, as well as threatened claims, by certain large insureds of insolvent insurance companies relating to the use and production of asbestos, silica, tobacco, and environmentally hazardous materials. The Association continues to evaluate the merits of these claims, the appropriateness of coverage under the Act, and the amount of potential liability to the Association.

Management includes in the reserve for claims and claims administration expense amounts estimated as the Association's liability for these claims based on present statutes and based on the best information available at this time. However, there are numerous and significant uncertainties regarding the amount of ultimate liability the Association may be responsible for under these claims and when amounts ultimately determined as owed by the Association become due and payable. As facts and circumstances develop, management intends to revise its estimates of these claims liabilities. Revisions in these estimates could result in significant increases or decreases in these estimates.

- (2) Due to the uncertainty of the timing and amount of claims to be paid by the Association, it is unknown whether the Association can meet its claims obligations as they become due. As described in Note 4, the Association has the statutory authority to assess up to 1% of member insureds' direct written premiums annually if necessary to pay its obligations. The Association financial resources also include receipt of investment earnings and the continued receipt of proceeds from liquidators of insolvent insurance companies.



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**Report on Compliance and on Internal Control over Financial Reporting**  
**Based on an Audit of Financial Statements Performed in**  
**Accordance with Government Auditing Standards**

Board of Directors  
Louisiana Insurance Guaranty Association  
Baton Rouge, Louisiana

We have audited the financial statements of Louisiana Insurance Guaranty Association as of and for the year ended December 31, 2003, and have issued our report there on dated March 4, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether Louisiana Insurance Guaranty Association's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Louisiana Insurance Guaranty Association's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operations that we considered to be reportable conditions. Reportable conditions involve matters coming to our attention related to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Association's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. We noted the following reportable condition:

**Reconciliation of Investment Account:** The Association reconciles the transaction activity in the investment custodial accounts maintained by the Association's investment manager to the activity reported in the Association's general ledger. Complete reconciliation procedures should also include reconciliation of the ending cost balances as reported on the monthly investment statements and the cost balances as reflected on the Association's general ledger.

We recommend that the Association's monthly reconciliation procedures be expanded to include reconciliation of the investment cost balances as reported by the investment manager to the investment balance maintained in the Association's general ledger. This reconciliation should be performed promptly, reconciling items investigated, and reviewed by another individual. Management has stated their agreement with this recommendation and implemented the expanded reconciliation procedures.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weakness. However, we believe that the reportable condition previously described is not a material weakness.

This report is intended solely for the information and use of the Board of Directors, management of the Louisiana Insurance Guaranty Association, the Commissioner of Insurance, State of Louisiana, and the Legislative Auditor, State of Louisiana and is not intended to be and should not be used by anyone other than these specified parties.

*Postlethwaite & Netterville*

Baton Rouge, Louisiana  
March 4, 2004

March 30, 2004

Office of Legislative Auditor  
State of Louisiana  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

**Re: 2003 Year End Audit Finding  
Corrective Action Plan**

Louisiana Insurance Guaranty Association (the "Association") respectfully submits the following corrective action plan for the year ended December 31, 2003.

The finding from Postlethwaite & Netterville's March 4, 2004 Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standard* for the year ended December 31, 2003 included the following finding:

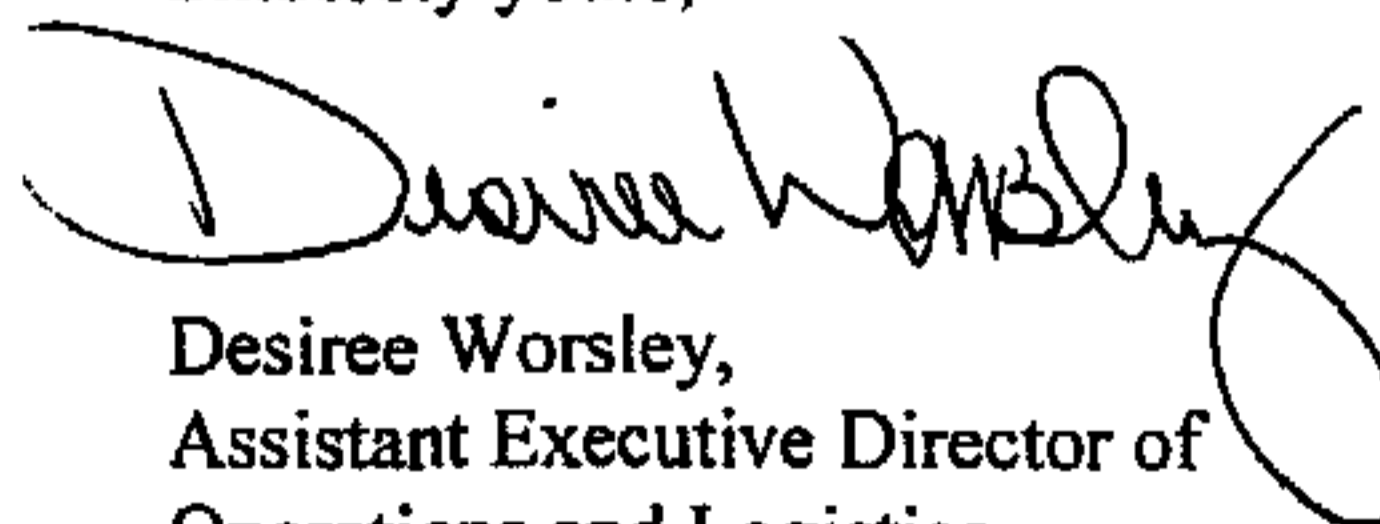
**Reportable Condition – Reconciliation of Investment Account**

**Recommendation:** We recommend that the Association's monthly reconciliation procedures be expanded to include reconciliation of the investment cost balances as reported by the investment manager to the investment balance maintained in the Association's general ledger. This reconciliation should be performed promptly, reconciling items investigated, and reviewed by another individual.

**Action Taken:** Effective January 2004, management implemented the recommended expanded reconciliation procedures into the Association's regular monthly reconciliation processes which is performed timely.

If the Louisiana Legislative Auditors' Office has questions regarding this plan, please contact me at 225-757-1688 ext 220.

Sincerely yours,

  
Desiree Worsley,  
Assistant Executive Director of  
Operations and Logistics