
HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

FINANCIAL STATEMENTS

DECEMBER 31, 2011



A Professional Accounting Corporation

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INDEPENDENT AUDITORS' REPORT

Officers and Trustees
Horsemen's Workers' Compensation Insurance Trust
Baton Rouge, Louisiana

We have audited the accompanying statement of net assets of Horsemen's Workers' Compensation Insurance Trust (the Trust) as of December 31, 2011, and the related statements of revenues, expenses and changes in net assets, and cash flows for the period from inception (July 16, 2011) to December 31, 2011. These financial statements are the responsibility of the Trust's management. 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 and with *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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Horsemen's Workers' Compensation Insurance Trust as of December 31, 2011, and the results of its operations and its cash flows for the period from inception (July 16, 2011) to December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report, dated June 29, 2012, on our consideration of the Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Postlethwaite + Netterville

Metairie, Louisiana
June 29, 2012

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

STATEMENT OF NET ASSETS
DECEMBER 31, 2011

ASSETS

| | | |
|----------------------------------|----|-----------------------|
| Cash held in claims escrow funds | \$ | 62,103 |
| Premiums receivable | | 56,810 |
| Prepaid excess insurance | | 269,014 |
| Other prepaid expenses | | 83,064 |
| Due from affiliates | | <u>67,545</u> |
| Total assets | \$ | <u><u>538,536</u></u> |

LIABILITIES AND NET ASSETS

| | | |
|----------------------------------|----|-----------------------|
| Liabilities: | | |
| Unpaid claims liability | \$ | 941,822 |
| Unearned premiums | | <u>7,003</u> |
| Total liabilities | | 948,825 |
| Net assets (deficit) | | <u>(410,289)</u> |
| Total liabilities and net assets | \$ | <u><u>538,536</u></u> |

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

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
PERIOD FROM INCEPTION (JULY 13, 2011) TO DECEMBER 31, 2011

Additions to net assets attributed to:

| | |
|---------------------------------|------------------|
| 1% workers compensation revenue | \$ 414,724 |
| Start premium revenue | 1,073,475 |
| Farm premium revenue | 98,318 |
| Total operating revenues | <u>1,586,517</u> |

Reductions to net assets attributed to:

| | |
|---------------------------|------------------|
| Claims expense | 1,132,083 |
| Excess insurance premiums | 233,688 |
| Claims handling fees | 36,661 |
| Professional fees | 108,136 |
| Management fees | 481,250 |
| Other | 4,988 |
| Total operating expenses | <u>1,996,806</u> |

CHANGE IN NET ASSETS (410,289)

NET ASSETS - AT INCEPTION -

NET ASSETS - END OF PERIOD \$ (410,289)

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

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

STATEMENT OF CASH FLOWS

PERIOD FROM INCEPTION (JULY 13, 2011) TO DECEMBER 31, 2011

| | |
|---|--------------|
| Cash flows from operating activities: | |
| Operating loss | \$ (410,289) |
| Adjustments to reconcile operating loss to net cash used in operations: | |
| Change in receivables | (56,810) |
| Change in prepaid excess insurance | (269,014) |
| Change in unpaid claims liability | 941,822 |
| Change in claims escrow funds | (62,103) |
| Change in other assets | (83,064) |
| Change in unearned premiums | 7,003 |
| Change in due from affiliates | (67,545) |
| | <hr/> |
| Net cash provided by (used in) operating activities | - |
| | <hr/> |
| Net change in cash | - |
| | <hr/> |
| Cash and cash equivalents, at inception | - |
| | <hr/> |
| Cash and cash equivalents, end of period | \$ - |
| | <hr/> <hr/> |

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

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Background and Organization

Horsemen's Workers' Compensation Insurance Trust (the Trust) was established on July 13, 2011 as a trust granted by Louisiana Revised Statute 4:251 and 4:252 to administer an insurance program for the purpose of providing workers' compensation insurance coverage and related benefits to members of the Louisiana Horsemen's Benevolent and Protective Association 1993, Inc. (the Association). The Trust began providing insurance coverage on July 16, 2011 which is considered the date of inception of operations. The Association was formed for the purpose of protecting the interest of the horse owners and trainers, particularly as it relates to their relationships with the owners and managers of race tracks. The purpose of the Trust is to provide workers' compensation insurance certificates of coverage and related benefits for certain workers participating in the horse racing industry and members of the Association. The Trust's objective is to formulate, develop, and administer a program of workers' compensation and loss control programs for the benefit of participants. This includes developing underwriting and rate-setting policies and administering benefits to claimants under the insurance certificates and to purchase excess insurance contracts for the benefit of the Trust.

Workers' compensation benefits provided by the Trust were previously provided to members of the Association pursuant to insurance policies issued by a third party and reinsured by Horsemen's Insurance Alliance SPC (HIA), which is incorporated in the Cayman Islands as a segregated portfolio company and a captive insurer owned by the Association. Effective July 16, 2011, the Trust began providing coverage to members, which were previously provided by a third party insurance policy in conjunction with HIA acting as the reinsurer for a specified amount of covered risks. All claims and other liabilities prior to this date remain the obligation of the third party insurer and HIA.

The Trust is administered by a Board of Trustees who are appointed by the Board of Directors of the Association. The Trust also contracts with the Association to act as the administrator and manager of the Trust and with other parties to perform certain functions to carry out the objectives of the Trust. The Trust and the Association are affiliated through common membership and management control and are considered to be related parties. Although these entities are related parties, their various net assets are available only to each individual entity for its operations.

In the event the Trust has excess assets available for a trust year of operations, the Trustees may, at their sole discretion, declare a dividend payable to members meeting eligibility requirements. Such a dividend will be payable only upon determination by the Board of Trustees and any necessary regulatory approvals.

(b) Basis of Accounting

The accompanying financial statements are presented in accordance with U.S. generally accepted accounting principles ("GAAP") and prevailing practices within the insurance industry. The Trust utilizes the accrual method of accounting for financial reporting purposes.

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) *Revenues and Accounts Receivable*

The Association obtains funding from statutorily dedicated funds described in the Louisiana Revised Statute (La R.S) 4:251 through 252, relative to workers' compensation insurance coverage. Pursuant to La R.S. 4:252 (c)(5), the Association receives 2% of all purses and purse supplements available for purses for any race meets in Louisiana. Use of these funds by the Association shall be solely for the purposes of establishing, operating, and administering the workers' compensation program as detailed in La R.S. 4:251B (1)(2)(3)(4)(5)(6). The Association determined that 1% of all purse money collected is to be contributed to the Trust to provide workers' compensation benefits and is included in these financial statements. The Association's workers' compensation insurance program also generates premium revenue charged based on either the number of race starts or per payroll level if the member is a non-racing farm. The Association formed the Trust for the purpose of carrying out this program of workers' compensation coverage subsequent to July 16, 2011. Subsequent to this date, all percentage of purse funds received and premiums charged to members on either a per-start or covered payroll basis by the Association were contributed to the Trust and included in revenues in these financial statements.

For Louisiana domiciled participants and participants who meet a Louisiana racing test, coverage is extended while temporarily participating in horse racing and/or training operations. For other participants, coverage is provided while operating at the Louisiana Race Tracks and Louisiana recognized Training Centers. Participants must obtain coverage through the Trust unless the Association declines to provide coverage. In such case, the trainer must provide evidence that other worker's compensation insurance is in place in order to race in Louisiana.

Louisiana domiciled participants and participants who meet a Louisiana racing test will pay premiums on a per start fee. There is a \$55 charge for in-state races. Participants for out-of-state and out-of-country races are charged a fee of \$75 to \$90 per start. Quarter Horse and Thoroughbred farms are charged based on their estimated annual payroll.

Revenues received from a percentage of purses or on a per-start basis are recognized as revenue by the Trust when the event occurs. Premiums from non-racing farms are recognized as revenues over the term of the coverage agreements as they become earned. This method of premium recognition is considered by management to reasonably represent the periods of risk of loss exposure. Premiums are also subject to verification and any adjustments to premiums or revenues are considered to be a change in estimate and are recognized in the period they become known.

The Trust considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been established. If accounts become uncollectible, they will be charged to operations when that determination is made. Collections on accounts previously written off are included in other income when received.

Acquisition costs associated with new and renewal coverage agreements are immaterial to the financial statements and are expensed when incurred.

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Unpaid Claims Liability

The Trust provides workers' compensation coverage to members for claims incurred during the policy period regardless of when the claims are reported to the Trust. The Trust establishes claims liabilities based on 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. The length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claims frequency, and other economic and social factors. 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. Estimated amounts of excess insurance recoverable on unpaid claims are deducted from the liability for unpaid claims.

Adjustments to claims liabilities are charged or credited to claims expense in the periods in which they are made. The carrying amount of liabilities for claims losses and claims expense are not discounted for the present value of future payments in the financial statements.

(e) Excess Insurance Contracts

The Trust enters into excess insurance agreements to reduce its exposure to large losses on insured events. Excess insurance permits recovery of a portion of losses from insurers, although it does not discharge the primary liability of the Trust as the direct insurer of the insured risks under the coverage agreement. The Trust does not report insured risks as liabilities unless it is probable that those risks will not be covered by insurers.

(f) Contributed Services

A portion of the Trust's functions are conducted by unpaid volunteer trustees and officers. The value of this contributed time is not reflected in the accompanying financial statements since it is not susceptible to objective measurement or valuation.

(g) Income Tax Status

The Trust intends to file for an exemption from federal income taxes under Sections 501(c)(4) of the Internal Revenue Code (IRC). Trust management and the Trust's legal counsel believe that the Trust is currently designed and operated in compliance with the applicable requirements of the IRC. Therefore, no provision for income taxes has been included in the Trust's financial statements.

The Trust is required to determine whether a tax position of the Trust is more likely than not to be sustained upon examination by the applicable taxing authority based on the technical merits of the position. Management does not believe there are any tax positions taken by the Trust that are subject to uncertainty and as a result, no provisions have been made in these financial statements.

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Insurance Related Assessments

The Trust may be subject to assessments made by the Louisiana Second Injury Fund and the Office of Workers' Compensation based on benefits paid each year. If the Trust is determined to be subject to these types of loss-based assessments, the Trust intends to recognize these assessments as expense when related claim benefits are incurred rather than paid. Changes in accruals for insurance related assessments are adjusted in the year assessment rate changes and claims estimates are made.

(i) Statements of Cash Flows

For purposes of the statement of cash flows, the Trust considers cash and cash equivalents to be short-term, highly liquid assets that are readily convertible to known amounts of cash.

(j) Use of Estimates

Management of the Trust has made a number of estimates and assumptions relating to the reporting of assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates and assumptions. For example, significant estimates and assumptions are used in estimating its insurance liabilities, and accruals. If future experience differs materially for these estimates and assumptions, the financial statements could be affected.

2. RELATED PARTY TRANSACTIONS

The Association provides various management and administrative functions for the benefit of the Trust, including the collection of the Trust's revenues. The Trust incurred management fees to the Association of \$481,250 during the period from inception (July 16, 2011) to December 31, 2011. At December 31, 2011, the Statement of Net Assets included \$67,545 due from the Association.

As previously described in Note 1, the Trust's purpose is to provide benefits for members of the Association and is dependent on the Association to contribute revenues to the Trust, which are statutorily derived. The Trust has operated at a deficit since its inception which included various costs associated with the formation and providing coverage previously provided to the Association's members by a third party and HIA. The Trust's viability is dependent on the Association for funding any cash flow needs and any deficits incurred by the Trust.

3. CLAIMS ESCROW FUNDS

At December 31, 2011, the funds held by a third party service provider, which are used to pay out claims, was \$62,103.

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

4. CLAIMS EXPENSE AND UNPAID CLAIMS LIABILITY

The following represents changes in the Trust's aggregate unpaid claims liabilities for the period from inception (July 16, 2011) to December 31, 2011:

| | |
|--------------------------|-------------------|
| Balance – at inception | \$ - |
| Net incurred related to: | |
| Current period | 1,132,083 |
| Prior periods | - |
| Total incurred | <u>1,132,083</u> |
| Net paid related to: | |
| Current period | 190,261 |
| Prior periods | - |
| Total paid | <u>190,261</u> |
| Balance – end of period | <u>\$ 941,822</u> |

The Trust engaged an independent consulting actuary to advise on the necessary level of reserve for losses and loss-adjustment expenses which are presented on an undiscounted basis. Through December 31, 2011, the Trust did not incur losses which were reasonably expected to reach the excess insurance attachment levels described in Note 5.

In the opinion of the Trust's management, these reserve estimates provisions are adequate to cover the estimated ultimate liability for the losses and loss-adjustment expenses at the balance sheet date. Consistent with most companies with similar insurance operations, the Trust's reserve for losses and loss-adjustment expenses is ultimately based on management's reasonable expectations of the future events. It is reasonably possible that the expectations associated with these amounts could change in the near term (i.e. within one year) and that the effect of such changes could be material to the financial statements. The Trust does not discount its reserves for losses and loss-adjustment expenses.

5. EXCESS INSURANCE COVERAGE

The Trusts purchases specific and aggregate excess insurance policies from New York Marine and General Insurance Company to limit the Trust's losses in excess of specified limits. The Trust's specific excess policy limited the Trust's losses to the retention amount for any single occurrence, up to a maximum benefit. The Fund's aggregate excess coverage provided protection against losses in the aggregate, subject to a minimum retention by the Trust.

The specific excess insurance obtained since inception provides coverage for each and every accident in excess of a \$400,000 retention amount retained by the Trust. The specific excess insurance provides coverage for all statutory benefits owed to the claimant under the Trust's coverage agreement.

The aggregate insurance excess insurance obtained since inception provides for coverage of aggregate losses for the coverage period ending July 1, 2012 exceeding 130% of earned normal premium which is estimated to be an aggregate attachment point of \$3,800,000. The aggregate excess insurance agreement provides for \$3,000,000 of coverage above this attachment point.

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

NOTES TO FINANCIAL STATEMENTS

5. EXCESS INSURANCE COVERAGE (continued)

As of December 31, 2011, the Trust had not incurred any claims which were reasonably expected to reach the excess insurance coverage levels. Accordingly, no amounts recoverable or receivable were recorded for amounts expected to be recovered under these agreements. The excess insurance contracts do not relieve the Trust from its obligations to claimants. The Trust remains liable to claimants for the portion insured to the extent that the excess insurer does not meet the obligations assumed under the excess insurance agreement. Failure of the excess insurers to honor their obligation could result in losses to the Trust.

6. SUBSEQUENT EVENTS

Management has evaluated events through the date that the financial statements were available to be issued, June 29, 2012, and determined that there were no events that required further disclosure. No subsequent events occurring after this date have been evaluated for inclusion in these financial statements.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Officers and Trustees
Horsemen's Workers' Compensation
Insurance Trust

We have audited the financial statements of Horsemen's Workers' Compensation Insurance Trust (the Trust), as of and for the period from inception (July 16, 2011) to December 31, 2011, and have issued our report thereon dated June 29, 2012. We have 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.

Internal Control Over Financial Reporting

Management of the Trust is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Trust's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bureau's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Trust's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that we consider to be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the management of the Horsemen's Workers' Compensation Insurance Trust and the Legislative Auditor of the State of Louisiana and is not intended to be and should not be used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Postlethwaite + Netterville

Metairie, Louisiana
June 29, 2012

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

DECEMBER 31, 2011

A. Summary of Auditor's Results

Financial Statements

Type of auditors' report issued: Unqualified

- Material weakness (es) identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses _____ Yes X No
- Material noncompliance to financial statements? _____ Yes X No

B. Basis Financial Statements, Findings, and Responses

None

SUPPLEMENTAL INFORMATION

HORSEMEN'S WORKERS' COMPENSATION INSURANCE TRUST

SCHEDULE OF TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
CLAIMS EXPENSE AND RE-ESTIMATED CLAIM ADJUSTMENT EXPENSE

DECEMBER 31, 2011

The table below illustrates the Trust's earned normal premium and investment income compared to related costs and claims expense (net of loss assumed by reinsurers) incurred by the Trust as of the end of 2011 and as of the end of each of the last nine years.

| | <u>2011</u> |
|--|--------------|
| ENP and investment income | \$ 1,586,517 |
| Operating costs, unallocated | 864,723 |
| Estimated incurred claims and expense, end of policy year | 941,821 |
| Paid (cumulative) as of: End of policy year | 190,262 |
| Re-estimated incurred claims and claims expense: End of policy year | 941,821 |
| Increase (decrease) in estimated incurred claims and expense from end of policy year | - |

See accompanying independent auditors' report.