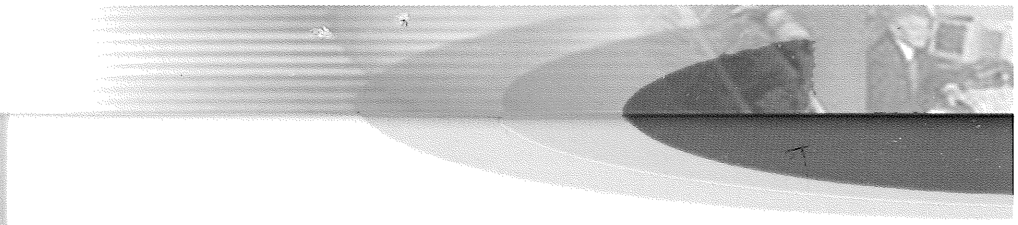
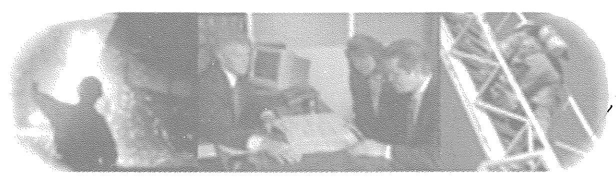


Workers' Compensation Reinsurance Association

2000 Annual Report



A Trusted Partner Serving Minnesota Since 1979

WCRA

TO OUR MEMBERS

On behalf of your Board of Directors and WCRA management, we are pleased to report that 2000 was an excellent year for your association. For the fourth time since 1992, the WCRA's strong financial position enabled the Board to approve a substantial surplus distribution. In addition, the association's staff continued to implement technology improvements that provide faster, more efficient reinsurance services.

Based on the association's available surplus at year-end 2000, the Board approved surplus distributions totaling $309.8 million to WCRA members and Minnesota workers' compensation policyholders. Insured employers will receive $42.1 million, and $267.7 million will be returned to WCRA members. Since its establishment in 1979, the WCRA has distributed $1.23 billion in surplus funds, $264 million more than the total premiums it has collected from members.

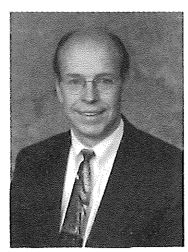
Three factors have contributed to the WCRA's financial strength.

> *Better-than-expected claims experience.* Both the frequency and severity of claims submitted to the WCRA by members have been lower than actuarially projected.
>
> *Careful expense management.* The association's operating budget has increased by less than 1 percent per year since 1990.
>
> *Superior investment performance.* Since 1979, the average annual return on the WCRA portfolio, net of fees, has averaged 12.7 percent. In 2000, our overall return was 7.85 percent while the S&P 500 lost 9.11 percent.

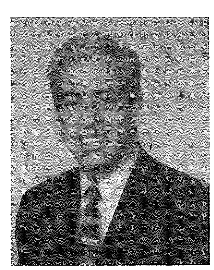
Advances in technology have changed the way your association serves you. Ten years ago, the WCRA had 37 staff members and annually processed 540 claim reimbursements in an average of 15 days per claim. In 2000, we had only 25 staff members, but we processed 2,028 claim reimbursements in an average of a single day per claim.

The following pages describe how the focus of this technological change is shifting from improving internal operating efficiency to enhancing member services. The WCRA Web site, www.wcra-mn.com, is the centerpiece for member communications. While we are not yet a paperless organization, members can use our online calculators to assist them in processing claims; access our Member's Reference Guide and our newsletter online; and, with the recent inauguration of our eMember site, submit claim reimbursement requests online.

The WCRA remains financially strong and will continue to develop new ways to serve you, our members, more cost effectively and efficiently.

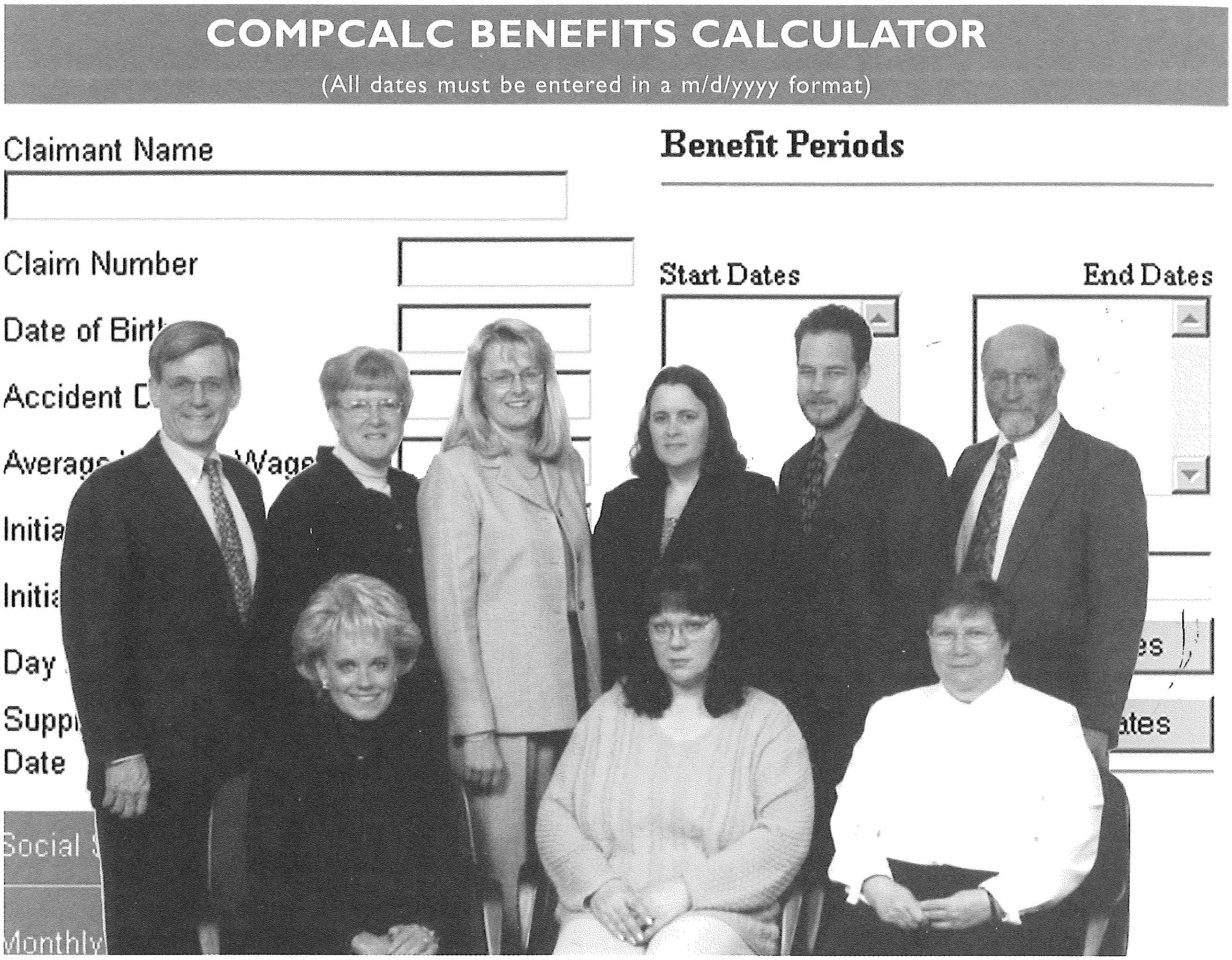


Michael Markman
Chair of the Board



Jay Benanav
President and Chief Executive Officer

CLAIMS SERVICES



Standing: Carl Cummins, Mary Fraser, Elisabeth Skoglund, Betsy Arntzen, Todd Johnson, Jerry Werner
Sitting: Jane Folsom, Jodi Elleraas, Judy Conley
Not pictured: Michelle Lemanski

Advances in technology have made a big difference in the WCRA claims services department. Several years ago, a new claims program was developed in-house, which has produced a much more streamlined work process. This in turn has resulted in amazing improvements in productivity and service to our members.

Comparing 1995 to 2000, the number of reimbursements processed and dollar amounts paid show a remarkable increase of 170 percent per staff member, while the turnaround time has been reduced to a single day. Yet the quality remains high due to computerized validations and control reports.

Increased automation at our members' organizations has also made an impact on claims service. By providing us with computerized payment ledgers instead of hand-written documentation, the reimbursement reconciliation process has significantly improved. In addition, e-mailing speeds up the information flow and allows us to respond to our members' requests faster.

Other technological innovations include the development of tools that make our work and the work of our members easier and more efficient. We developed calculators for estimating settlement values, computing the amount of benefits that should have been paid, permanency calculations, etc. Once we realized how useful the calculators were, they were added to our Web site for the benefit of our members and others involved in the workers' compensation system. These tools have become the most popular features of the site as members realize that they make their jobs easier, too. The calculators and their functions are described below.

> *CompCalc* calculates the correct Minnesota indemnity benefit rate. This tool came in particularly handy for many claim handlers when they calculated benefit adjustments required as a result of the *Charley v. FMC Corporation* decision.
>
> *PPD Calc – Multiple Body Parts* computes percentages of permanent partial disability when an injury involves more than one body part.
>
> *PPD Calc – Amount* calculates the amount of permanent partial disability benefits based on the individual rating.
>
> *InterestCalc* computes the interest on late workers' compensation benefit payments.
>
> *PresentValueCalc* calculates the present value of a benefit after selecting the escalation and discount rates and is particularly useful in settlement evaluations.
>
> *LifeExpectancyCalc* provides expected life depending on gender and current age.

In addition, the Web site offers medical and rehabilitation links as a resource for the claims services staff and for members to access professional information and research about severe injuries. The Web site also contains a section that provides several handy charts and tables used in administering workers' compensation claims in Minnesota.

We will continually strive to improve our services. With the recent deployment of our eMember site and wire transfers, our members can now have their reimbursement money in the bank the same day their request is submitted! Your WCRA claims services representative can assist you in identifying how our services can benefit your organization.

INFORMATION SYSTEMS

Historically, the primary goal of the WCRA information systems (IS) department has been to provide the WCRA staff with the systems tools that allow them to perform their jobs as effectively as possible. However, the role of the IS department has expanded in the last few years. With the development of the WCRA Web site, the department not only serves the needs of our staff but is assisting our members and other interested persons by making sure the Web site and its components are reliably available and up to date. Based on the 7,000 visitors in 2000 and very few service calls, the users are satisfied with our Web services.

The WCRA Web site was initially published in July of 1999. We have developed it from a "brochureware only" site into a useful interactive tool. The calculators, listed on the Web site under the claims services department, attract about 90 percent of the page hits. In addition to these calculators, claims forms and other documents may be downloaded, and information such as address corrections may be submitted to the WCRA via electronically.

The most recent new Web feature is our *eMember* site, which was developed entirely in-house. This is a secure site that provides members with contact, premium, and claims data for their individual organizations. Members are able to report claims and request reimbursements electronically. Our first eMembers have been activated, and the claims services department receives their daily loss reporting forms and reimbursement requests online.

In addition, an e-mailing service was recently deployed. By adding your e-mail address to *eNotice,* you will be notified when something of interest happens at the WCRA and when new features are published on the Web site.

Left to right: Elisabeth Skoglund, Christian King, Eva McClellan

An enhanced Web site will be published in the near future. In addition to a new look and improved functionality, users will be offered a choice of receiving the *WCRA Member's Reference Guide* in Web format, in normal printout, or on CD. Keeping up with new developments in technology remains the IS department's challenge. Our ultimate goal is to provide members with a complete set of resources on the WCRA and Minnesota's workers' compensation system, either through information we provide on the Web site or via links to related sites. If you have any suggestions for services you would like to see online, e-mail us at webmaster@wcra-mn.com.

ACTUARIAL SERVICES


Left to right: Julie Olson, Jonathan Taylor, Jane Jasper Krumrie, Ann Dominik

Dramatic improvements in technology have facilitated the complex analytical tasks that are an integral part of the actuarial department's work at the WCRA. Individual claim reserves are established using the *Case Reserve Program;* premium rate indications are based on the output of our *Pricing Model;* and future financial results are projected using our *Asset/Liability Forecasting and Analysis (ALFA)* model. Each of these three tools was custom written and designed to meet the WCRA's specific needs and requirements. Preparation of meeting books and presentation materials is accomplished utilizing a variety of computer programs to enhance and clarify the actuarial issues presented to our Board and committee members.

Case Reserve Program - The Case Reserve Program is written in Visual Basic and uses data from the claims services department to calculate appropriate case reserves for each claim submitted to the association. Recent changes in the program have reduced the number of claims that require the claims services staff to set reserves manually, helping to streamline our process and increase the consistency of our reserves.

Pricing Model - The Pricing Model is a program written in Quick Basic that uses a Monte Carlo simulation to generate 20,000 hypothetical claims. The model estimates the WCRA costs for these sample claims based on relevant assumptions that help us determine appropriate rate levels. This modeling is particularly important because our excess reinsurance business produces few losses to evaluate actuarially.

ALFA Model - The ALFA model is our most recent technological advancement. The model is an integral part of a new program being implemented by the Board to shape future WCRA fiscal policy. ALFA can analyze a variety of economic conditions and forecast the impact of different approaches to handling the association's surpluses or deficits over the next six decades. (Six decades represents a full working lifetime and about two economic cycles.)

More information regarding the WCRA's pricing and reserves is available in the Financial Services area on the WCRA Web site.

FINANCIAL SERVICES

The finance department at the WCRA is responsible for three key aspects of the association's business: finance support operations, investment operations, and member/premium services.

Finance support operations include the typical tasks and functions that all businesses perform to keep the overall operations running smoothly: daily cash management, accounts payable, accounting, and financial reporting, as examples. Like many businesses, the association is accomplishing these functions more efficiently through the use of advanced technology. While computers, software applications, or even online access to bank information are not new, these tools are essential to efficiently managing these "back-office" tasks and providing effective support so the staff at the WCRA can focus on service to its members.

Front row: Lori Thompson, Sharon Sullivan, Jeanne Mann
Back row: Keith Summers, Mary Johnson, Gary Severson, Jennifer Lenzen

The second key aspect of the association's business is its investment operations. The WCRA business strategy relies heavily on its investment results because an expected earnings rate is built into the reinsurance rates charged to members. Setting an appropriate long-term expected earnings rate for the investment portfolio is dependent not only on financial and economic analyses and projections, but clear communications with the outside investment firms and the custodian bank hired by the WCRA to manage the funds. New information systems have greatly improved the quality of the financial analyses conducted by the WCRA staff, such as defining an appropriate earnings expectation, analyzing performance results, or monitoring the allocation of the portfolio within the asset classes defined in the investment policy. These technologies also support gathering information more quickly for staff analysis, whether it is instantaneous results from our investment managers, more rapid communication with our custodian bank, or accessing data on the markets.

Increasingly, technology is supporting more effective communications between the WCRA and the investment firms with which it deals. Electronic newsletters, correspondence by e-mail, and Internet access to portfolio information (which is updated daily) have made information available more quickly. This provides increased time for researching, decision-making, and understanding expectations and results within the investment operations.

The business function managed by the finance department that is most visible to the members is the member premium services. Here technology plays a significant role in the WCRA's ability to work with our members in organizing and managing data to ensure that the association is providing accurate and adequate information about their reinsurance coverage. The most important tool in accomplishing this is the WCRA premium system, a proprietary computer program that integrates company contacts, company affiliations, exposure information, and premium receivables management into one application. This program supports all the tasks related to the premium side of the association's business: issuing renewal certificates, mailing newsletters, requesting annual exposure information, and sending invoices for premiums. We will continue to integrate more functions into the premium system to ensure that we leverage our technology investment to provide a high level of data quality and service to our members.

WCRA BOARD OF DIRECTORS

Standing: Bradley Robinson (Robinson Rubber Company), Donald Gerdesmeier (Minnesota D.R.I.V.E.), Laurence Koll (Koll, Morrison, and Charpentier), Bernard Brommer (AFL-CIO), Howard Bicker (State of Minnesota),

Sitting: George Klouda (Western National Mutual Insurance Company), Gary Swoverland (Land O'Lakes), David Young (Liberty Mutual Insurance Company), Mary Paidosh (Cherokee National Bank)

Not pictured: Pamela Wheelock (State of Minnesota), Susan Herboldt (Itasca County), Stephen Lilienthal (The St. Paul Companies), Michael Markman (Zurich Insurance Group)

MANAGEMENT'S SUMMARY ANALYSIS OF 2000 FINANCIAL RESULTS

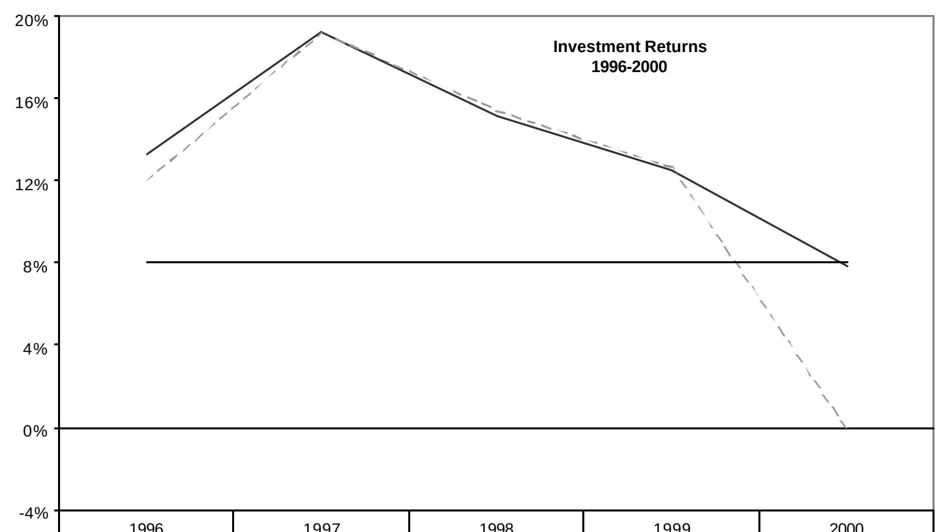
The year 2000 was an excellent financial year for the WCRA in spite of increasing volatility in the financial markets. Building upon the success of prior years, the investment portfolio delivered sufficient positive returns that, even as the stock market fell, comprehensive income of over $61.8 million was added to the association's surplus. This increased the total surplus to over $570 million and provided the resources to enable the WCRA Board of Directors to declare a $309.8 million distribution of excess funds to members and Minnesota workers' compensation policyholders.

Investment Portfolio

The net investment portfolio exceeded $1.39 billion in value at the end of the fiscal year, an increase of over $90 million from the preceding year. The portfolio earned 7.85 percent for the year, exceeding its WCRA custom benchmark return for the first time in five years. This excellent performance represented over $100 million in earnings and is primarily due to the association's asset allocation decision to overweight value and small-cap stocks relative to the broad US stock market. The chart below depicts the actual versus benchmark performance for the last five years.

Liabilities for Funded Losses

Liabilities of $818.9 million for funded losses and loss adjustment expenses were reported at December 31, 2000. This is an increase of $31.7 million compared to 1999. An 8 percent discount rate is reflected in year-end 1999 and 2000 reserves.



	1996	1997	1998	1999	2000
Actual	13.29%	19.24%	15.19%	12.51%	7.85%
Benchmark	11.94%	19.24%	15.42%	12.64%	-0.05%
Long Term Rate of Return	8.00%	8.00%	8.00%	8.00%	8.00%

Discounted WCRA Funded Losses and LAE Incurred
(in millions)

	2000	1999
On prior accident years:		
Present value update	$61.4	$56.8
Payments made during calendar year	39.4	35.9
Reduction of reserves for payments made	-39.4	-35.9
Revisions to projected funded ultimate losses	-14.7	-69.2
	46.7	-12.4
On the current accident year:	24.4	23.9
Total funded losses and LAE incurred	$71.1	$11.5

Management improved the methodology for analyzing the funded reserves, including incorporating the results of a lifetime medical payment study and the introduction of an enhanced blend of pricing and individual case discount factors to represent future loss payments in today's dollars.

Evaluating the Financial Surplus

Prior to the Board declaring a distribution of excess surplus, the year-end 2000 financial surplus stood at over $570 million. The Board of Directors previously determined that a surplus of 32 percent of funded reserves represents an adequate surplus to cushion the WCRA from adverse investment and actuarial events. Accordingly, the Board determined that excess funds of $309.8 million should be refunded to WCRA members and workers' compensation policyholders in accordance with the requirements of the WCRA's enabling statutes, Minnesota Statutes Sections 79.34-79.40.

Calculation of Distribution of WCRA Excess Funds
(in millions)

Financial Surplus prior to Excess Funds Distribution	$571.8
32% of Funded Reserves of $818.9	262.0
Excess Funds Available for Distribution	$309.8
Payable to WCRA Members	$267.7
Payable to Minnesota Workers' Compensation Policyholders	$42.1

Subsequent Events

The WCRA Board of Directors approved the $309.8 million surplus distribution on March 8, 2001. Following regulatory approval of the distribution by the Commissioner of Labor and Industry and the Commissioner of Commerce on March 28, management moved quickly to implement the distribution. Surplus distributions to self-insurer members were completed by May 1, 2001. Insurer members are required by law to provide data on their 2000 workers' compensation insureds by June 6. Distributions to insurers will be made as they submit this policyholder data. The association intends to have completed the surplus distribution to policyholders by the end of August 2001.

During 2000, staff reevaluated the long-term rate of return used in pricing and in setting reserve levels. Based upon an analysis of historical returns over long time horizons and using our proprietary Asset Liability Forecasting and Analysis system (ALFA), staff recommended reducing the expected long-term rate of return to 7.5 percent, down from 8 percent. The Board of Directors subsequently revised the discount rate to be used for determining future reserves to 7.5 percent effective March 9, 2001. The impact of this decision is to increase the association's funded loss and loss expense reserves by $50 million and to decrease total surplus by the same amount going forward.

Report of Independent Accountants

To the Board of Directors and Members
Workers' Compensation Reinsurance Association:

In our opinion, the accompanying balance sheets and the related statements of operations, comprehensive income and surplus and cash flows present fairly, in all material respects, the financial position of the Workers' Compensation Reinsurance Association at December 31, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 8, 2001

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Balance Sheets
At December 31, 2000 and 1999
(In thousands)

	2000	1999
ASSETS		
Investments, at market value:		
Cash and cash equivalents (including securities lending collateral of $263,859 and $233,811 at December 31, 2000 and 1999, respectively)	$ 310,109	$ 292,886
Common and preferred stock	806,963	780,276
Bonds	727,811	492,405
Total investments	1,844,883	1,565,567
Uncollected reinsurance premiums:		
Due for funded losses	29	179
Deferred for catastrophic losses	65,656	75,759
Total uncollected reinsurance premiums	65,685	75,938
Accrued investment income	7,091	6,139
Due from securities brokers	103,307	15,434
Accounts receivable and prepaid expenses	154	86
Property and equipment, less accumulated depreciation of $640 and $571 at December 31, 2000 and 1999, respectively	450	437
Total assets	$ 2,021,570	$ 1,663,601
LIABILITIES AND SURPLUS		
Liabilities:		
Losses and loss adjustment expenses:		
Funded	$ 818,878	$ 787,132
Catastrophic	65,656	75,759
Total losses and loss adjustment expenses	884,534	862,891
Payable under securities loan agreement	263,859	233,811
Due to securities brokers	301,061	56,499
Excess funds distribution payable (Note 4)	309,837	--
Accounts payable and accrued expenses	238	374
Total liabilities	1,759,529	1,153,575
Contingencies		
Surplus from operations	165,411	364,299
Accumulated other comprehensive income	96,630	145,727
Total surplus, including designated surplus of $262,041 in 2000 and $251,900 in 1999 (Note 2)	262,041	510,026
Total liabilities and surplus	$ 2,021,570	$ 1,663,601

The accompanying notes are an integral part of the financial statements

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Statements of Operations, Comprehensive Income and Surplus
For the years ended December 31, 2000 and 1999
(In thousands)

	2000	1999
Revenues:		
Reinsurance premiums:		
Funded	$ 33,733	$ 29,771
Catastrophic	(10,103)	11,993
Premiums earned	23,630	41,764
Investment income, net of related expenses	44,475	37,723
Net realized investment gains	106,120	164,376
Total revenues	174,225	243,863
Expenses:		
Losses and loss adjustment expenses:		
Funded	71,176	11,550
Catastrophic	(10,103)	11,993
Losses and loss adjustment expenses incurred	61,073	23,543
Operating and administrative expenses	2,203	2,118
Total expenses	63,276	25,661
Net income	110,949	218,202
Other comprehensive income:		
Change in unrealized losses on securities	(49,097)	(57,189)
Comprehensive income	61,852	161,013
Surplus, beginning of year	510,026	349,013
Excess funds distribution	(309,837)	–
Surplus, end of year	$ 262,041	$ 510,026

The accompanying notes are an integral part of the financial statements

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Statements of Cash Flows
At December 31, 2000 and 1999
(In thousands)

	2000	1999
Cash flows from operating activities:		
Funded premiums collected	$ 33,883	$ 29,470
Interest and dividends received, net of related expenses	42,389	35,967
Loss and loss adjustment expenses paid	(39,430)	(35,991)
Operating and administrative expenses paid	(2,284)	(1,786)
Net cash provided by operating activities	34,558	27,660
Cash flows from investing activities:		
Sale of investments:		
Common and preferred stocks	1,064,539	789,397
Bonds	2,176,298	975,577
Purchase of investments:		
Common and preferred stocks	(1,059,547)	(732,169)
Bonds	(2,228,540)	(1,056,765)
Collateral for securities on loan	30,048	79,332
Restricted cash and cash equivalents	3	8,860
Purchase of equipment	(136)	(426)
Net cash (used in) provided by investing activities	(17,335)	63,806
Cash flows from financing activities:		
Payments on excess funds distribution payable	--	(4,786)
Net cash used in financing activities	–	(4,786)
Change in cash and cash equivalents	17,223	86,680
Cash and cash equivalents, beginning of year	292,886	206,206
Cash and cash equivalents, end of year	$ 310,109	$ 292,886

The accompanying notes are an integral part of the financial statements

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Footnotes

1. General Information

Description of Association

In 1979, the Minnesota Legislature created the Workers' Compensation Reinsurance Association (the Association), a tax-exempt nonprofit, unincorporated association, to provide reinsurance protection for serious workers' compensation losses to all primary workers' compensation insurance providers and self-insured employers in the state of Minnesota. The Association provides full indemnification to its members for workers' compensation losses under Minnesota Statutes Chapter 176 in excess of a member's retention limit.

Operating rules and procedures are prescribed by Minnesota Statutes Section 79.34-79.40, as amended, (the Enabling Act) and the Plan of Operation. Amendments to the Plan of Operation must be approved by the Board of Directors of the Association (the Board) and the Minnesota Commissioner of Labor and Industry.

Membership

All insurance carriers authorized to underwrite workers' compensation risks in Minnesota and all employers authorized to self-insure their workers' compensation liabilities in Minnesota are required to be members of the Association.

Retention Limit

For 2000, members selected one of three maximum per loss occurrence retention limits, which were $310,000, $620,000 or $1,240,000. For 1999, members selected one of three maximum per loss occurrence retention limits, which were $290,000, $580,000 or $1,160,000. Workers' compensation losses incurred by members in excess of the retention limit selected are reinsured by the Association.

Premiums

The estimated aggregate annual reinsurance premium billed by the Association to members in each calendar year is calculated to cover the following estimated costs:

* the present value, using a discount rate of eight percent, of the estimated ultimate liability for members' incurred losses up to and including the prefunded limit of $6.2 million per occurrence for 2000 ($5.8 million per occurrence for 1999) for funded losses reinsured by the Association;

* payments, if any, made to members on claims in excess of the prefunded limit (catastrophic losses);

* loss adjustment, operating, and administrative expenses of the Association (loss adjustment expenses incurred by members on reinsured claims are not recoverable from the Association); and

* adjustments due to excess or deficient funded premiums, if any, for prior years as determined by the Board.

Estimated reinsurance premiums for each year are billed to the individual members based on: (1) the rate for the member's selected retention limit; and (2) the member's most recent actual exposure base available at the beginning of the annual billing cycle adjusted, beginning in 1996, for a factor which represents the estimated difference between the member's most recent actual exposure base and the actuarially projected exposure base. In the following year, reinsurance premium adjustments to bring the estimated premiums to actual are calculated and billed or credited to members.

For insurer members, the exposure base is the standard earned premium at the designated statistical reporting level reported in the Annual Financial Call for Experience to the Minnesota Workers' Compensation Insurers Association (MWCIA) multiplied by 1.20. Experience rating modifications of the insurers' individual insureds are reflected in the Annual Call data.

For self-insurer members, the exposure base is calculated from Minnesota's covered payroll, multiplied by pure premium base rates as published by the MWCIA, multiplied by 1.20, multiplied by an experience rating modification factor.

2. Summary of Significant Accounting Policies

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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Risks and Uncertainties

The Association invests in stocks and bonds of U.S. and foreign companies, U.S. government securities and mortgage-backed securities. The investment viability and return of funds is dependent on, among other factors, the financial results of the underlying issuers. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values will occur in the near term and that such changes could materially affect the financial statements.

Comprehensive Income

The Association follows the reporting concept of "Comprehensive Income" which requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. Comprehensive income for the Association includes net income and unrealized gains and losses (other comprehensive income) on available-for-sale securities.

Cash Equivalents

Cash on deposit, shares in money market funds, and short-term debt securities with original maturities of three months or less are classified as cash equivalents.

Investments

The Association has classified its investments as "available-for-sale" and carries such securities at fair market value based on quoted market prices. Accordingly, the net unrealized gains or losses are included in other comprehensive income as a separate component of surplus. In determining the realized gain or loss on sales of investments, cost is based on the average cost method. Interest income is recognized when earned. Dividend income is recognized on the ex-dividend date.

Property and Equipment
Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Upon sale or retirement of property and equipment, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to operations.

Determination of Surplus
After the close of each fiscal year or at such other times that it deems appropriate, the Board reports whether a surplus or deficit exists based on the annual audited year-end financial statements. In determining whether or not to declare an excess surplus distribution or a deficiency assessment, the Board evaluates surplus or deficit relative to the reserves for discounted funded loss and loss adjustment expenses. This provision is intended to maintain sufficient assets to provide for variations between expected and actual investment returns, variations between expected and actual claims experience, and other unexpected financial developments. As a result of this practice, an amount has been reflected on the balance sheet as designated surplus and is calculated at 32 percent of funded losses.

The Board may declare an excess surplus distribution or a deficiency assessment if no such distribution or assessment has been declared in the preceding four years, provided that distributions or assessments may be more or less frequently than every five years if the Board, in its sole discretion, determines that it is necessary and prudent to do so. Excess surplus distributions or deficiency assessments may be declared by the Board and distributed to or collected from self-insurer members or policyholders pursuant to the provisions of Minnesota Laws, Chapter 361, as interpreted by decisions of the United States District Court in I*n re Workers' Compensation Refund*, entered February 11, 1994 and affirmed by the Eighth Circuit Court of Appeals on January 31, 1995; and *American Compensation Insurance Company, et al, v. David B. Gruenes, as Commissioner of the Minnesota Department of Commerce, et al.,* entered February 9, 1998.

Reinsurance Premiums
The reinsurance premiums for the calendar year coverage period for funded losses (losses up to and including the prefunded limit) consist of the billed funded premiums. The reinsurance premiums for the calendar years may also include a credit or charge to equitably distribute excess or deficient premiums for previous periods including any excess or deficient premium resulting from a retroactive change in the prefunded limit.

The reinsurance premiums to be billed in future years for catastrophic losses (losses in excess of the prefunded limit) incurred during the calendar year coverage period are recognized as revenue concurrent with the related catastrophic losses and loss adjustment expenses. The reinsurance premiums for catastrophic losses will be billed to the members of the Association when payments on those catastrophic losses are made.

Losses and Loss Adjustment Expenses
The liability for funded losses and loss adjustment expenses represents the present value, discounted at 8 percent, of the estimated liability for losses and loss adjustment expenses of the Association for unpaid amounts up to and including the prefunded limit, as determined by actuarial projections using historical pricing model simulations and the payment and case reserve experience of the Association.

The liability for catastrophic losses and loss adjustment expenses represents the present value, discounted at 8 percent, of the estimated liability for losses and loss adjustment expenses of the Association for unpaid amounts in excess of the prefunded limit, as determined by actuarial projections of the Association.

The liability for losses and loss adjustment expenses at December 31, 2000 and 1999 is summarized as follows (in thousands):

	2000	1999
Funded, undiscounted	$ 3,084,814	$ 3,043,982
Discount	(2,265,936)	(2,256,850)
	818,878	787,132
Catastrophic, undiscounted	1,274,634	1,131,767
Discount	(1,208,978)	(1,056,008)
	65,656	75,759
Total	$ 884,534	$ 862,891

Activity in the funded liability for losses and loss adjustment expenses is summarized as follows (in thousands):

	2000	1999
Balance, January 1:		
Funded, undiscounted	$ 3,043,982	$ 3,128,417
Incurred related to:		
Current year	152,866	163,746
Prior years	(72,604)	(212,190)
Total incurred	80,262	(48,444)
Paid related to:		
Current year	40	42
Prior years	39,390	35,949
Total paid	39,430	35,991
Balance, December 31:		
Funded, undiscounted	3,084,814	3,043,982
Discount	(2,256,936)	(2,256,850)
	$ 818,878	$ 787,132

Reserves are reviewed periodically and updated based on current claims experience and trends. Adjustments to the estimated liability for losses and loss adjustment expenses are reflected in operating results in the year when the changes are made. These adjustments may be material to the financial statements when they occur. In 2000 and 1999, actuarial adjustments on prior accident years, including changes in selected ultimate loss amounts, decreased funded discounted reserves and related losses and loss adjustment expenses by approximately $14.7 million and $69.2 million, respectively.

In 2000, actuarial adjustments on prior accident years are a combination of the following factors quantified below:

	December 31, 2000 Impact on Funded Undiscounted Ultimate Loss and Loss Expense (Millions)	December 31, 2000 Impact on Funded Discounted Loss and Loss Expense Reserves (Millions)
Upward development and annual adjustment of actuarial credibility weights	$ (.2)	$ (5.8)
Changes in pricing assumptions	(72.4)	(6.5)
Changes in discount factor methodology	---	(2.4)
2000 total	$ (72.6)	$ (14.7)

In 1999, actuarial adjustments on prior accident years were a combination of the following factors quantified below:

	December 31, 1999 Impact on Funded Undiscounted Ultimate Loss and Loss Expense (Millions)	December 31, 1999 Impact on Funded Discounted Loss and Loss Expense Reserves (Millions)
Downward development and annual adjustment of actuarial credibility weights	$ (227.9)	$ (75.1)
Changes in pricing assumptions	15.7	5.9
1999 total	$ (212.2)	$ (69.2)

Two major enhancements were implemented for the 2000 WCRA funded reserve analysis. First, several factors introduced during the most recent pricing review were incorporated into the pricing component of the WCRA's reserving procedures. The most significant of these pricing factors is the lifetime medical payment study done in the spring of 2000. This project enhanced the WCRA's methodology for projecting future medical costs of lifetime, half-lifetime, and nonlifetime claims. Other factors related to pricing include an updated wage distribution and revisions in underlying frequency assumptions for all claim groups. Second, selected discount factors used to represent future loss payments in today's dollars now reflect an enhanced blend of pricing and individual case discount factors. The enhanced blend reflects the implied credibility weights of the Association's claim count analysis. The funded reserve decreases arising from these two major enhancements, pricing and discount factors, total $8.9 million, discounted at 8 percent. The $8.9 million represents the majority of the overall funded reserve decrease of $14.7 million for year-end 2000 actuarial adjustments on prior accident years.

The following chart compares all of the funded reserve changes during 2000 with those of 1999 on a discounted basis:

Present Value of Funded Reserve Changes (in millions)	**2000**	**1999**
Reserve changes due to prior-year actuarial impact (discounted at 8%)	$ (14.7)	$ (69.2)
Payments during 2000 on accident years 1999 and prior	(39.4)	(35.9)
Present value update (calculated at 8%)	61.4	56.8
Reserves for accident year 2000 (discounted at 8%)	24.4	23.9
Total of funded reserve changes during calendar year	$ 31.7	$ (24.4)

3. Income Tax Status

In 1996, the Association was granted an exemption from federal income taxes under Section 501(c)(27) of the Internal Revenue Code (IRC). The Association received a tax-exempt determination letter from the IRS dated February 7, 1997. Therefore, no provision for income taxes is included in the Association's financial statements.

4. Excess Funds Distribution

In December 2000, based on projected year-end financial results, the Board of Directors determined that there was a projected surplus of approximately $500 million, which constituted an extraordinary accumulation of surplus in excess of funds necessary to meet the Association's long-term liabilities. This surplus was attributable to a combination of reductions in funded loss and loss adjustment expense reserves and positive investment performance. As a result, on March 8, 2001, the Board declared a distribution of $309.8 million, which is equal to the Association's 2000 adjusted surplus, less an amount equal to 32 percent of the funded loss and loss adjustment expense reserves, discounted at 8 percent, as calculated in accordance with the Operating Rule for the Determination of Surplus. Management estimates the funds will be distributed as follows (in millions):

Minnesota policyholders	$ 42.1
Member self-insurers	65.6
Member insurers	202.1
	$ 309.8

In addition, on March 8, 2001, the Board of Directors approved the use of 7.5 percent as the discount rate to be used to determine its reserves, effective March 9, 2001. The impact of this decision is to increase uncollected reinsurance premiums deferred for catastrophic losses in the amount of $10.7 million, to increase liabilities for funded and catastrophic losses and loss adjustment expenses in the amount of $60.7 million, and to decrease total surplus in the amount of $50 million.

5. Cash Flows

A reconciliation of net income to net cash provided by operating activities for the years ended December 31, 2000 and 1999, is as follows (in thousands):

	2000	1999
Net income	$ 110,949	$ 218,202
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized investment gains	(106,120)	(164,376)
(Increase) decrease in funded uncollected reinsurance premiums, net of accrued premium adjustments	150	(301)
Increase (decrease) in liability for funded losses and loss adjustment expenses	31,746	(24,441)
Other, net	(2,167)	(1,424)
Total adjustments	(76,391)	(190,542)
Net cash provided by operating activities	$ 34,558	$ 27,660

6. Investments

The cost of common and preferred stocks, amortized cost of bonds, and estimated fair values at December 31, 2000 and 1999, respectively, are as follows (in thousands):

	2000			
	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 711,641	$ 152,052	$ (61,521)	$ 802,172
Preferred stocks	5,126	---	(335)	4,791
Total stocks	$ 716,767	$ 152,052	$ (61,856)	$ 806,963
U.S. Treasury securities and obligations of U.S. government and agencies	$ 120,751	$ 3,150	$ (384)	$ 123,517
Corporate debt securities	298,321	5,132	(7,043)	296,410
Mortgage backed securities	302,305	6,374	(795)	307,884
Total bonds	$ 721,377	$ 14,656	$ (8,222)	$ 727,811

	1999			
	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 611,700	$ 202,565	$ (40,061)	$ 774,204
Preferred stocks	6,627	---	(555)	6,072
Total stocks	$ 618,327	$ 202,565	$ (40,616)	$ 780,276
U.S. Treasury securities and obligations of U.S. government and agencies	$ 91,066	$ 73	$ (2,398)	$ 88,741
Corporate debt securities	262,729	1,610	(9,825)	254,514
Mortgage backed securities	154,832	326	(6,008)	149,150
Total bonds	$ 508,627	$ 2,009	$ (18,231)	$ 492,405

The amortized cost and estimated fair value of debt securities at December 31, 2000, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 16,002	$ 16,250
Due after one year through five years	137,534	137,165
Due after five years through ten years	130,232	130,713
Due after ten years	437,609	443,683
Total	$ 721,377	$ 727,811

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Other comprehensive income in 2000 and 1999 is comprised of only the change in unrealized gains (losses) on available-for-sale securities arising during the year less realized gains (losses) included in income as follows

	2000	1999
Unrealized holding gains	$ 57,023	$ 107,187
Reclassification adjustment for gains included in net income	(106,120)	(164,376)
Net other comprehensive loss	$ (49,097)	$ (57,189)

Gross gains of $274 million and $181 million and gross losses of $168 million and $16 million were realized on sales of investments during 2000 and 1999, respectively. Net investment income and net realized investment gains (losses) during the years ended December 31, 2000 and 1999, are summarized below (in thousands):

	Net Investment Income		Net Realized Gains (Losses)	
	2000	1999	2000	1999
Securities lending	$ 366	$ 211	$ ---	$ ---
Cash and cash equivalents	3,577	3,216	3,466	(2,626)
Common and preferred stocks	10,165	10,214	102,343	176,568
Bonds	35,543	28,721	311	(9,566)
Miscellaneous	390	403	---	---
	50,041	42,765	$ 106,120	$ 164,376
Investment expenses	(5,566)	(5,042)		
	$ 44,475	$ 37,723		

To enhance the return on investments, the Association maintains a securities lending program. At December 31, 2000 and 1999, the Association had equity and fixed income securities with fair values of $254 million and $225 million out on loan, respectively. Cash of at least 102 percent of the fair value of the securities lent was held as collateral as part of the securities lending program.

The Association reflects the collateral received for securities on loan on the balance sheet if the secured party has control over the collateral. An asset of $264 million and $234 million and the related liability representing the collateral received is reflected on the balance sheet as of December 31, 2000 and 1999, respectively.

To further enhance the return on investments, some of the Association's investment managers have entered into interest-rate future, stock index future, and interest-rate option contracts. Listed contracts must be traded on a market regulated by a governmental agency, and counterparties must have a long-term debt rating of "A" or better. Future contracts are marked-to-market on a daily basis with the gain or loss reported in income. Option contracts are valued at fair value with the gain or loss reported in income at the time the option is exercised or the contract is settled.

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