

**THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
Raleigh, North Carolina**

**FINANCIAL STATEMENTS
June 30, 2009**

**Performed Under Contract with the
North Carolina Office of the State Auditor**

**Beth A. Wood, CPA
State Auditor**



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Board of Directors, The North Carolina Health Insurance Risk Pool, Inc.

This report presents the results of the financial statement audit of The North Carolina Health Insurance Risk Pool, Inc. (the Pool), a component unit of the State of North Carolina, for the year ended June 30, 2009. Clifton Gunderson, L.L.P. performed this audit under contract with the Office of the State Auditor and their report is submitted herewith.

North Carolina General Statute 58-50-235 requires an audit of the Pool to be conducted annually under the oversight of the State Auditor. General Statute 147-64.7 allows the State Auditor to obtain the services of independent public accountants.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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Independent Auditor's Report

Board of Directors
The North Carolina Health Insurance Risk Pool, Inc.
d/b/a Inclusive Health
Raleigh, North Carolina

We have audited the accompanying statement of net assets of The North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health (the Pool), a component unit of the State of North Carolina, as of June 30, 2009, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Pool'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 the 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 misstatements. 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 the Pool as of June 30, 2009, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 12, 2010, on our consideration of the Pool's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is presented fairly, in all material respects, in relation to the basic financial statements taken as a whole.

Clifton Gunderson LLP

Raleigh, North Carolina
April 12, 2010

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009

This section of the financial statements presents a discussion and analysis of the financial performance of the North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health (the Pool) as of and for the year ended June 30, 2009. Please read it in conjunction with the financial statements, which follow this section. The Pool was established by North Carolina General Statute on July 1, 2007. Prior to September 2008, the Pool was maintained as a separate fund within the North Carolina Department of Insurance.

The Pool commenced activity as a separate entity during the year ended June 30, 2009, and as such, the 2008 comparative information is from its activity as a separate fund of the North Carolina Department of Insurance.

Overview of the Financial Statements

This discussion and analysis is an introduction to the Pool's basic financial statements, which comprise basic financial statements, and notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements.

The following is a brief description of the Pool's three basic financial statements:

Statement of Net Assets - This statement presents information reflecting the Pool's assets, liabilities and net assets.

Statement of Revenues, Expenses and Changes in Net Assets - This statement reflects the operating revenues and expenses, as well as nonoperating revenues and expenses of the Pool. The Pool's major source of operating revenues is premium income, with the major source of operating expenses being policyholder benefits. The change in net assets is similar to net profit or loss for any other insurance company.

Statement of Cash Flows -The statement of cash flows is presented on the direct method of reporting which reflects cash flows from operating, capital and related financing, noncapital and related financing, and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase in cash and cash equivalents for the fiscal year. Due to timing differences associated with accrual accounting, net cash provided by operating activities is different than the amount of operating loss reported on the statement of revenues, expenses and changes in net assets; therefore, a reconciliation is also provided.

FINANCIAL SUMMARY

The following table summarizes the financial position of the Pool at June 30, 2009 and 2008, respectively.

Summary of Net Assets

	2009	2008
Assets		
Cash and cash equivalents	\$ 19,188,907	\$ 864,776
Other	5,209,160	22,361
Capital	<u>10,312</u>	<u>10,638</u>
Total assets	<u>24,408,379</u>	<u>897,775</u>
Liabilities	<u>2,972,635</u>	<u>13,339</u>
Net assets		
Invested in capital assets	10,312	10,638
Unrestricted	<u>21,425,432</u>	<u>873,798</u>
Total	<u><u>\$ 21,435,744</u></u>	<u><u>\$ 884,436</u></u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009
(Continued)

Total Assets

Total assets primarily consist of cash and cash equivalents and amounts due from the North Carolina Health and Wellness Trust Fund which were received from the State of North Carolina to fund the initial operating activities of the Pool.

Total Liabilities

The most significant components of the Pool's liabilities are related to unpaid claims and claim adjustment expenses which are calculated by the Pool's actuary. The change in the unpaid claims liability between 2009 and 2008 amounted to an increase of \$2.3 million. The increase during 2009 is primarily related to this being the Pool's first full year of operations.

The following table summarizes the changes in net assets for fiscal year ended June 30:

Summary of Revenues, Expenses and Changes in Net Assets

	<u>2009</u>	<u>2008</u>
Operating revenues		
Premiums earned	\$ 2,607,553	\$ -
Total operating revenues	<u>2,607,553</u>	<u>-</u>
Operating expenses		
Policyholder claims	3,919,494	-
Contractual expenses	779,455	-
Personnel expenses	277,478	-
General expenses	<u>163,893</u>	<u>221,457</u>
Total operating expenses	<u>5,140,320</u>	<u>221,457</u>
Operating loss	<u>(2,532,767)</u>	<u>(221,457)</u>
Nonoperating income		
State aid	22,871,880	1,100,000
Interest income	<u>212,195</u>	<u>5,893</u>
Total nonoperating revenues	<u>23,084,075</u>	<u>1,105,893</u>
Change in net assets	20,551,308	884,436
Net assets – beginning of year	<u>884,436</u>	<u>-</u>
Net assets – end of year	<u>\$ 21,435,744</u>	<u>\$ 884,436</u>

RESULTS OF OPERATIONS

Revenues

Total operating revenues increased by approximately \$2.8 million. This was primarily due to 2009 being the year the Pool commenced writing premiums. The initial premiums had effective dates as of January 1, 2009.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009
(Concluded)

Expenses

Operating expenses are comprised of policyholder claims and the Pool's general and administrative expenses.

Operating expenses were approximately \$4.9 million greater than 2008. This was primarily due to 2009 being the first full year of operations of the Pool.

Nonoperating Revenues

Nonoperating revenues increased by \$21.8 million. This was the result of the commencement in 2009 of the statutory funding sources as set forth by the North Carolina General Assembly House Bill that created the Pool. Nonoperating revenues consist of revenues from State of North Carolina sources. The Pool received \$5,000,000 from the Health and Wellness Trust Fund; \$17,153,194 from North Carolina premium tax receipts; and \$718,686 from the State Health Plan. These amounts are directed to the Pool under legislation passed by the General Assembly.

Information Requests

This financial report is designed to provide the members of the Pool and General Assembly of the State of North Carolina with a general overview of the Pool's finances, and to demonstrate the Pool's accountability for the money it receives. Questions concerning this report or requests for additional financial information should be addressed to Michael Keough, Executive Director; North Carolina Health Insurance Risk Pool, Inc., 3739 National Drive; Suite 228; Raleigh, North Carolina 27612-4844; (866) 665-2117.

BASIC FINANCIAL STATEMENTS

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENT OF NET ASSETS
June 30, 2009

ASSETS

ASSETS

Cash and cash equivalents	\$ 19,188,907
Premiums receivable, net of allowance of \$100,000	53,551
Due from North Carolina Health and Wellness Trust Fund	5,000,000
Due from third party administrator	138,087
Prepaid expenses	<u>17,522</u>

Total assets	<u>24,398,067</u>
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CAPITAL ASSETS - DEPRECIABLE

Furniture and equipment	12,623
Accumulated depreciation	<u>(2,311)</u>

Total capital assets	<u>10,312</u>
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TOTAL ASSETS	<u>\$ 24,408,379</u>
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LIABILITIES AND NET ASSETS

LIABILITIES

Unpaid claims	2,343,306
Unpaid claim adjustment expenses	98,000
Accounts payable	24,600
Unearned premiums	429,952
Advance premiums	71,057
Other liabilities	<u>5,720</u>

Total liabilities	<u>2,972,635</u>
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NET ASSETS

Invested in capital assets	10,312
Unrestricted	<u>21,425,432</u>

TOTAL NET ASSETS	<u>\$ 21,435,744</u>
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The accompanying notes to the financial statement are an integral part of this statement.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Year Ended June 30, 2009

OPERATING REVENUES	
Premiums earned	\$ 2,607,553
Total operating revenues	<u>2,607,553</u>
OPERATING EXPENSES	
Policyholder claims	3,919,494
Contractual expenses	779,455
Personnel expenses	277,478
General expenses	<u>163,893</u>
Total claims and other expenses	<u>5,140,320</u>
NET OPERATING LOSS	(2,532,767)
NONOPERATING REVENUE	
State aid revenue	22,871,880
Interest income	<u>212,195</u>
Total nonoperating revenues	<u>23,084,075</u>
CHANGE IN NET ASSETS	20,551,308
NET ASSETS, BEGINNING OF YEAR	<u>884,436</u>
NET ASSETS, END OF YEAR	<u><u>\$ 21,435,744</u></u>

The accompanying notes to the financial statement are an integral part of this statement.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENT OF CASH FLOWS
Year Ended June 30, 2009

CASH FLOWS FROM OPERATING ACTIVITIES

Premiums received	\$ 2,955,011
Policyholder claims paid	(1,718,865)
Payments to employees and benefits	(280,507)
Payments to vendors and suppliers	<u>(713,937)</u>
Net cash provided by operating activities	<u>241,702</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State aid received	<u>17,871,880</u>
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**CASH FLOWS FROM CAPITAL AND RELATED
FINANCING ACTIVITIES**

Purchase of capital assets	<u>(1,646)</u>
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CASH FLOWS FROM INVESTING ACTIVITIES

Interest income received	<u>212,195</u>
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NET INCREASE IN CASH AND CASH EQUIVALENTS

18,324,131

CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR

864,776

CASH AND CASH EQUIVALENTS, END OF YEAR

\$ 19,188,907

**RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED
BY OPERATING ACTIVITIES**

Net operating loss	\$ (2,532,767)
Adjustments to reconcile net income to net cash provided by operating activities:	
Bad debts	100,000
Depreciation	1,972
Effects of changes in operating assets and liabilities:	
Premiums receivable	(153,551)
Due from third party administrator	(138,087)
Prepaid expenses	4,839
Unpaid claims	2,338,716
Unpaid claim adjustment expenses	98,000
Accounts payable	24,600
Unearned premiums	429,952
Advance premiums	71,057
Other liabilities	<u>(3,029)</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES

\$ 241,702

The accompanying notes to the financial statement are an integral part of this statement.

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THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health (the Pool) was created by the North Carolina General Assembly in 2007 to provide affordable individual health insurance coverage for residents of North Carolina who do not have access to an employer health plan. It also offers coverage to individuals who are federally defined as HIPAA eligible or qualify under the Health Coverage Tax Credit due to loss of employment due to the effects of international trade.

The Pool is a non-profit entity organized under IRC section 501(c)(26) and is deemed a component unit of the State of North Carolina. Inclusive Health is governed by its own Board of Directors.

Financial Reporting Entity

The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The Pool is a component unit of the State of North Carolina and is an integral part of the State's *Comprehensive Annual Financial Report*.

Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on, the State.

The Pool is governed by a 12-member board. As required by General Statute, the Commissioner of Insurance serves as an ex-officio, nonvoting member, one member is appointed by the Governor, two members are appointed by the General Assembly, and eight members are appointed by the Commissioner of Insurance. The State has obligated itself to provide significant funding to the Pool, creating a financial benefit/burden relationship. Because of the State's appointment of the board and the benefit/burden relationship, the Pool is a component unit of the State of North Carolina and the Pool's financial statements are included in the State's *Comprehensive Annual Financial Report*. The accompanying financial statements for the Pool are separate and apart from those of the State of North Carolina and do not present the financial position of the State nor changes in the State's financial position and cash flows.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation

The financial statements are prepared in accordance with generally accepted accounting principles using the accrual method of accounting as it relates to proprietary fund activities of governmental entities.

The Pool's financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement no. 34 *"Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments."* The financial statement presentation provides a comprehensive look at the total entity.

GASB Statement No. 34 identified three types of special-purpose governments (SPG): 1) those engaged only in governmental activities, 2) those engaged only in business-type activities, and 3) those engaged in both governmental and business-type activities. Business-type activities are financed in whole or in part by fees charged to external parties for goods and services.

The Pool adopted the financial reporting model required of SPG's engaged in business-type activities (BTA). Entities reporting as BTAs follow GASB standards applicable to proprietary (enterprise) funds. The BTA model requires the following financial statement components.

- * Management's Discussion and Analysis
- * Statement of Net Assets
- * Statement of Revenues, Expenses and Changes in Net Assets
- * Statement of Cash Flows
- * Notes to the Financial Statements

The financial statements of the Pool have been prepared on the accrual basis of accounting whereby all revenues are recorded when earned and all expenses are recorded when they have been reduced to a legal contractual obligation to pay. The statements are intended to report the Pool as an economic unit that includes all measurable assets and liabilities, financial and capital, of the Pool. The Pool's financial statements are prepared using the format of a special-purpose governmental entity engaged only in business-type activities with an economic resources measurement focus and the accrual basis of accounting.

The Statement of Revenues, Expenses, and Changes in Net Assets for special-purpose governments engaged in business-type activities (BTA) requires an operating/nonoperating format to be used. The Statement of Cash Flows is presented as the direct method which depicts cash flows from operating activities and a reconciliation of operating cash flows to operating income.

GASB Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,"* as amended by GASB Statement No. 29, *"The Use of Not-For-Profit Accounting and Financial Reporting Principles by Governmental Entities"* permits such entities to apply all those Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989 that are developed for business enterprises except for those that conflict with or contradict GASB pronouncements. The Pool has elected not to implement FASB pronouncements issued after that date for any proprietary fund type activity.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

One of the primary purposes of financial reporting is to account for resources received and used, as well as accounted for and reported. In certain situations, both restricted and unrestricted net assets may be available to cover an expense incurred. In those few cases, as long as the expense meets all of the requirements of the restricted net assets, restricted resources would be applied first.

Net Assets

The Pool's net assets are classified as Invested in Capital Assets, which represents the Pool's total investment in capital assets, and Unrestricted net assets, which include all resources not invested in capital assets

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that directly affect the results of reported amounts and disclosures. Accordingly, actual results may differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and highly liquid financial instruments with an original maturity of three months or less at the date of acquisition. The Pool's cash equivalents consist of a money market account with a bank.

Premiums Receivable

The Pool grants credit to policyholders for premiums. Collateral is not required to secure receivables. Premiums receivable are recorded at their net realized values. Management accounts for bad debts using the allowance method. Management reviews all outstanding accounts receivable and estimates an allowance based on the age of the accounts, credit worthiness of the member, and historical payments. The allowance for doubtful accounts at June 30, 2009 was \$100,000.

Amounts billed to members are generally due upon receipt and are contractually past due after 30 days. The Pool does not accrue finance charges on past due accounts. Past due premiums receivables, which were older than 90 days at June 30, 2009, were \$46,767.

Capital Assets

Capital assets are recorded at cost or fair value at the date of donation. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets, which vary between 5 and 7 years. Depreciation expense for the year ended June 30, 2009 was \$1,972.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments in excess of \$500, and a life in excess of one year, are capitalized. The cost and related accumulated depreciation of property and equipment are removed from the books upon retirement or other disposition; any resulting profit or loss is reflected in the Statement of Revenues, Expenses and Changes in Net Assets.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Policyholder Claims and Claim Adjustment Expenses

Policyholder claims and claim adjustment expenses are charged to operations as incurred. The Pool does not discount the liabilities for unpaid claims and claim adjustment expenses. Liabilities for unpaid claims and claim adjustment expenses are determined based on historical experience and include both reported but not paid and incurred but not reported claims. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes the liabilities for unpaid claims and claim adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations. The Pool does not anticipate investment income in determining if a premium deficiency exists.

Revenue Recognition

Premiums are generally recognized as revenue on a pro rata basis over the term of the policy. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums in the Statement of Net Assets.

The Pool classifies its revenues as operating or nonoperating in the accompanying Statement of Revenues, Expenses and Changes in Net Assets. Operating revenues generally result from providing services in connection with the Pool's ongoing operations. Operating revenues include activities that have characteristics of exchange transactions. Nonoperating revenues are from public funding sources of the State of North Carolina. For the year ended June 30, 2009, nonoperating revenue sources accounted for 89% of all revenues.

Reinsurance

The Pool limits the maximum net loss that can arise from large risks by reinsuring (or ceding) certain levels of risk with a reinsurer under a reinsurance treaty. Ceded reinsurance is treated as the risk and liability of the reinsuring company. Amounts recoverable from the reinsurer are estimated and recognized in a manner consistent with the claims liabilities arising from reinsured policies including incurred but not reported claims.

Income Taxes

The Pool is exempt from payment of income taxes under the provision of Section 501(c)(26) of the Internal Revenue Code, except to the extent of taxes on any unrelated business income.

NOTE 2 – CASH AND CASH EQUIVALENTS

The Pool maintains its cash balances in a federally insured banking institution. The Pool has cash balances at June 30, 2009 as follows:

	Carrying Amount	Bank Balance
Cash	\$ 1,281,690	\$ 1,667,113
Money market account at bank	<u>17,907,217</u>	<u>17,907,217</u>
	<u>\$19,188,907</u>	<u>\$19,574,330</u>

All of the cash and cash equivalents were held at a single financial institution at June 30, 2009.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 2 – CASH AND CASH EQUIVALENTS (CONTINUED)

Custodial credit risk is the risk that, in the event of a bank failure, the Pool's deposits may not be returned. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are (a) uncollateralized, (b) collateralized with securities held by pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the Pool's name.

At June 30, 2009, the bank balance of \$1,667,113 was covered by FDIC insurance under the Temporary Liquidity Guarantee Program through December 31, 2009. However, the money market account was not covered by FDIC insurance or collateralized, and as such, was exposed to custodial credit risk.

The Pool may only invest unspent funds in interest-bearing bank accounts.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Pool's policy for managing its exposure to fair value loss arising from increasing interest rates is to maintain its cash and cash equivalents in savings and money market accounts.

NOTE 3 – CHANGE IN CAPITAL ASSETS

	Beginning Balance	Additions and Transfers	Deletions and Transfers	Ending Balance
Depreciable Capital Assets:				
Furniture and equipment	\$ 10,977	\$ 1,646	\$ -	\$ 12,623
Accumulated depreciation	<u>(339)</u>	<u>(1,972)</u>	<u>-</u>	<u>(2,311)</u>
Net	<u><u>\$ 10,638</u></u>	<u><u>\$ (326)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 10,312</u></u>

NOTE 4 – LIABILITY FOR UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

Activity in the liability for unpaid claims and claim adjustment expenses is summarized as follows:

Balance at July 1:	<u>\$ 4,590</u>
Incurring related to:	
Current year	4,337,287
Prior years	<u>-</u>
Total incurred	<u>4,337,287</u>
Paid related to:	
Current year	1,895,981
Prior years	<u>4,590</u>
Total paid	<u>1,900,571</u>
Balance at June 30:	<u><u>\$ 2,441,306</u></u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 4 – LIABILITY FOR UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES
(CONTINUED)

Claim adjustment expenses of \$417,793 have been included in contractual expenses in the accompanying Statement of Revenues, Expenses and Changes in Net Assets. There was no adjustment needed for incurred claims and claim adjustment expenses related to prior years. The changes in estimates are generally the result of ongoing analysis of claim development trends. Original estimates are adjusted as additional information becomes known regarding individual claims. A premium deficiency reserve of \$175,000 has been included in the above balance as of June 30, 2009 on policies in force since the loss is probable and can be reasonably estimated.

NOTE 5 – REINSURANCE ACTIVITY

The Pool cedes a portion of its direct business to a reinsurance company. Such reinsurance includes excess of loss on certain coverages. The Pool retains a maximum of \$250,000 of coverage per covered person, subject to a 90% coinsurance. The liability to the reinsurer is also limited to \$750,000 per covered person, subject to a lifetime limit of \$1,000,000. This reinsurance contract does not relieve the Pool from its obligations to policyholders. Failure of the reinsurer to honor its obligations could result in losses to the Pool; consequently, allowances are established for amounts deemed uncollectible. No such allowances were considered necessary for 2009. The Pool does not generally require collateral to secure reinsurance recoverables, but periodically evaluates the financial condition of the reinsurer and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurer to minimize its exposure to significant losses from reinsurer insolvency.

Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy. At June 30, 2009, there were no net reinsurance receivables and prepaids.

The effect of reinsurance on premiums written and earned for the year ended June 30, 2009 is as follows:

	Written	Earned
Direct	\$ 3,092,674	\$ 2,662,722
Ceded	<u>55,169</u>	<u>55,169</u>
Net	<u><u>\$ 3,037,505</u></u>	<u><u>\$ 2,607,553</u></u>

There were no recoveries related to the reinsurance contracts that were deducted from policyholder benefits for 2009.

NOTE 6 – LEASE COMMITMENTS

The Pool has entered into an operating lease for its office space. The lease expires April 2010. Lease expense for the year ended June 30, 2009 was \$17,666. Future minimum rental payments at June 30, 2009 are \$16,931.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2009

NOTE 7 – RETIREMENT PLAN

The Pool has established a 401(k) plan for its employees. Employees who meet age and length of service requirements are eligible to participate. The Pool matches employee contributions at 100% to a maximum of 6% of eligible salary. For the year ended June 30, 2009, the Pool's contributions to the plan were \$12,667 based on eligible salaries of \$221,767.

NOTE 8 – PUBLIC FUNDING

The Pool's major sources of funding are from the State of North Carolina based on premium taxes assessed on health insurance policies issued throughout the State and a contribution from the North Carolina Health and Wellness Trust Fund.

It is uncertain as to the level of premium tax revenue that will be received in the future. General economic conditions and employment levels throughout the state of North Carolina will negatively or positively affect the amount of premium tax collected in a given year. In addition, there is uncertainty as to the amount of contribution that will be received from the North Carolina Health and Wellness Trust Fund in future years. That amount is determined annually by the General Assembly of North Carolina. Without continued future state revenues, there exists the possibility that premium revenue will not be sufficient in future years to cover all claims expenses.

NOTE 9 – RISK MANAGEMENT

The Pool is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets; errors and omissions; injuries to employees; employees' health and life; and natural disaster. The Pool manages these various risks of loss as follows:

Type of Loss	Method Managed	Risk of Loss Retained
Torts, errors and omissions, health and life	Purchased commercial insurance	None
Workers Compensation – employee injuries	Purchased commercial insurance	None
Physical property loss and natural disasters	Purchased commercial insurance	None

Management believes such coverage is sufficient to preclude any significant losses to the Pool. Settled claims have not exceeded this insurance coverage in any of the past three fiscal years.

SUPPLEMENTAL INFORMATION

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
SCHEDULE OF OTHER EXPENSES
Year Ended June 30, 2009

CONTRACTUAL EXPENSES

Accounting	\$ 39,446
Actuarial services	43,916
Administrative services	417,793
Advertising and marketing	128,282
Information technology	27,350
Legal	61,695
Producer compensation	35,114
Other contractual expenses	<u>25,859</u>
Total contractual expenses	<u>779,455</u>

PERSONNEL EXPENSES

Insurance	10,405
Payroll taxes	16,716
Retirement plan contribution	12,667
Salaries	221,767
Travel	12,671
Other personnel expenses	<u>3,252</u>
Total personnel expenses	<u>277,478</u>

GENERAL EXPENSES

Bad debts	100,000
Insurance	18,284
Postage and delivery	5,334
Rent	17,666
Telephone	9,274
Other general expenses	<u>13,335</u>
Total general expenses	<u>163,893</u>

TOTAL OTHER EXPENSES

\$ 1,220,826

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**Independent Auditor's Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of the Financial Statements Performed
in Accordance with *Government Auditing Standards***

Board of Directors
The North Carolina Health Insurance Risk Pool, Inc.
d/b/a Inclusive Health
Raleigh, North Carolina

We have audited the financial statements of The North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health (the Pool), a component unit of the State of North Carolina, as of and for the year ended June 30, 2009, and have issued our report thereon dated April 12, 2010. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Pool'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 Pool's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Pool's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Pool's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Pool's financial statements that is more than inconsequential will not be prevented or detected by the Pool's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Pool's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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 Pool'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*.

We noted certain matters that we reported to management of the Pool in a separate letter dated April 12, 2010.

This report is intended solely for the information and use of the Board of Directors, management, the Governor, and the General Assembly of North Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Raleigh, North Carolina
April 12, 2010

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

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