The North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health

Financial Statements

Year Ended June 30, 2010

Performed under Contract with the North Carolina Office of the State Auditor

Beth A. Wood, CPA
State Auditor

DIXON HUGHES PLLC
Certified Public Accountants and Advisors

The North Carolina Health Insurance Risk Pool, Inc.
d/b/a Inclusive Health

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DIXON HUGHES PLLC
Certified Public Accountants and Advisors

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, 2010, 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 misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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, 2010, 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 February 22, 2011, 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.

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The management's discussion and analysis on pages 3 through 5 and the supplemental schedule of Two-Year Claim Development on pages 18 and 19 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires 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 of the Pool, taken as a whole. The Schedule of Other Expenses in the accompanying supplementary information is presented for purposes of additional analysis and is not a require part of the basic financial statements of the Pool. 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.

Dixon Hughes PLLC

February 22, 2011

This section of the annual financial report of The North Carolina Health Insurance Risk Pool, Inc. d/b/a Inclusive Health (the Pool) presents a discussion and analysis of the financial performance of the Pool as of and for the year ended June 30, 2010. Please read it in conjunction with the basic financial statements, which follow this section.

Overview of the Financial Statements

The Pool's basic financial statements are prepared in accordance with U.S. generally accepted accounting principles for governmental entities. 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. The Pool also offers coverage to individuals who are federally defined HIPAA eligible or qualify under the Health Coverage Tax Credit due to loss of employment due to effects of international trade. The basic financial statements are presented on the accrual basis of accounting. The three basic financial statements presented within the financial statements are as follows:

Statement of Net Assets - This statement presents information reflecting the Pool's assets, liabilities and net assets. Net assets represent the amount of total assets less total liabilities. The statement of net assets is categorized as to current and noncurrent assets and liabilities. For purposes of the basic financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or become due within 12 months of the statement date.

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 claims expense. 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, 2010 and 2009, respectively.

Summary of Net Assets

	2010	2009
Assets		
Cash and cash equivalents	$ 17,366,284	$ 19,188,906
Fixed income and equity securities	17,746,839	-
Other assets	1,167,768	5,209,161
Capital assets	8,231	10,312
Total assets	36,289,122	24,408,379
Liabilities	4,464,842	2,972,635

Summary of Net Assets (Continued)

	2010	2009
Net assets		
Invested in capital assets	$ 8,231	$ 10,312
Unrestricted	31,816,049	21,425,432
Total	$ 31,824,280	$ 21,435,744

Total Assets

Total assets consisted of a range of asset classes led by cash and cash equivalents, fixed income and equity securities and federal grant receivables, which is included in other assets. The total change of $11,880,743 from 2009 to 2010 was driven by an increase of $17,746,839 in fixed income and equity securities as the plan transferred newly received reserve balances into longer term investment accounts. The major offset to this was the absence of the $5,000,000 transfer from the Health & Wellness Trust Fund that was by statute a one-time first year event, which was funded during the current fiscal year.

Total Liabilities

The most significant components of the Pool's liabilities are unpaid claims and claims adjustment expenses which totaled $3,544,138 in 2010. That represents an increase of $1,102,832 over 2009. The increase is commensurate with the increased enrollment and claims activity in 2010.

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

Summary of Revenues, Expenses and Changes in Net Assets

	2010	2009
Operating revenues		
Premiums earned	$ 15,323,244	$ 2,607,553
Total operating revenues	15,323,244	2,607,553
Operating expenses		
Claims expenses	13,713,729	3,919,494
Contractual expenses	1,691,721	779,455
Personnel expenses	237,400	277,478
General expenses	87,651	163,893
Total operating expenses	15,730,501	5,140,320
Operating loss	(407,257)	(2,532,767)
Non-operating income		
State aid	8,953,118	22,871,880
Noncapital grants	1,500,000	-
Investment	342,675	212,195
Total non-operating revenues	10,795,793	23,084,075
Change in net assets	10,388,536	20,551,308
Net assets – beginning of year	21,435,744	884,436
Net assets – end of year	$ 31,824,280	$ 21,435,744

RESULTS OF OPERATIONS

Revenues

Total revenues increased $427,409 or 1.7% from $25,691,628 at June 30, 2009 to $26,119,037 at June 30, 2010. This was driven by an increase in operating revenues of $12,715,691, which was offset by a decrease in nonoperating revenues of $12,288,282. The increase of operating revenue was comprised solely of earned premiums, which increased commensurate with the Pool's increased enrollment in 2010. The offsetting decrease in nonoperating revenues was comprised of two key components, a decrease in premium tax revenue from the North Carolina Department of Insurance of $8,943,468 and a $5,000,000 contribution from the North Carolina Health and Wellness Trust Fund that was made in 2009. The Pool did receive a Federal Grant in the amount of $1,500,000 during 2010, which is included nonoperating revenues.

Expenses

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

Operating expenses totaled $15,730,501 in 2010 representing an increase of $10,590,181 over the prior year. The operating loss decreased by $2,532,767 to $407,257 with the rise in premium revenue and the reduction in start up costs that contributed to the 2009 loss.

Future Conditions and Facts

Subsequent to June 30, 2010, the Pool contracted with the US DHHS to administer the new federal Pre-Existing Condition Insurance Plan as a separate line of business. The federal pool is managed, tracked, financed and reported on separately. The federal government funds the ongoing difference between member premiums and actual total costs.

There are separate eligibility requirements for the federal pool under which only North Carolinians who have been without creditable coverage for 6 months are eligible. Initial forecasts that it would lead to a drop of as much as 20% in state pool enrollment have not materialized thus far with an actual decrease of 2% since enrollment started on July 1, 2010.

The potential impact of the state budget crisis on Inclusive Health's state premium tax revenue is unclear. Its impact will not be felt until the 2011-2012 plan fiscal year asthe next payment is due in October 2011.

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; (919) 783-5766.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a/ INCLUSIVE HEALTH
STATEMENT OF NET ASSETS
June 30, 2010

		2010
ASSETS		
Current assets:		
Cash and cash equivalents	$	17,366,284
Fixed income securities		3,637,426
Equity securities		9,366,860
Accrued interest		97,939
Premiums receivable, net of allowance of $75,000		11,599
Federal grant receivable		837,543
Other receivables		200,586
Other assets		20,101
Total current assets		31,538,338
Noncurrent assets:		
Fixed income securities		4,742,553
Capital assets, net of accumulated depreciation of $4,392		8,231
Total noncurrent assets		4,750,784
TOTAL ASSETS	$	36,289,122
LIABILITIES AND NET ASSETS		
LIABILITIES		
Unpaid claims and claims adjustment expenses	$	3,544,138
Accounts payable		194,602
Unearned premiums		587,453
Advance premiums		125,188
Other liabilities		13,461
Total current liabilities		4,464,842
NET ASSETS		
Invested in capital assets		8,231
Unrestricted		31,816,049
Total net assets		31,824,280
TOTAL LIABILITIES AND NET ASSETS	$	36,289,122

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Year Ended June 30, 2010

		2010
OPERATING REVENUES		
Premiums earned, net		$ 15,323,244
	TOTAL OPERATING REVENUES	15,323,244
OPERATING EXPENSES		
Claims expense		13,713,729
Contractual expenses		1,691,721
Personnel expenses		237,400
General expenses		87,651
	TOTAL OPERATING EXPENSES	15,730,501
NET OPERATING LOSS		(407,257)
NONOPERATING REVENUE		
State aid		8,953,118
Noncapital grants		1,500,000
Investment income		342,675
	TOTAL NONOPERATING REVENUE	10,795,793
CHANGE IN NET ASSETS		10,388,536
NET ASSETS, BEGINNING OF YEAR		21,435,744
	NET ASSETS, END OF YEAR	$ 31,824,280

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a/ INCLUSIVE HEALTH
STATEMENTS OF CASH FLOWS
Year Ended June 30, 2010

	2010
CASH FLOWS FROM OPERATING ACTIVITIES	
Premiums received	$ 15,610,452
Claims paid	(12,472,810)
Payments to employees and benefits	(238,283)
Payments to vendors and suppliers	(1,740,832)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,158,527
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State and federal aid received	14,520,958
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchases of fixed income securities	(9,274,132)
Purchases of equity securities	(9,300,000)
Proceeds from the sale of fixed income securities	800,000
Investment income received	272,025
NET CASH USED BY INVESTING ACTIVITIES	(17,502,107)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,822,622)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	19,188,906
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 17,366,284
RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Net operating loss	$ (407,257)
Adjustments to reconcile net loss to net cash provided by operating activities	
Bad debts	(25,000)
Depreciation	2,081
Decrease (increase) in operating assets:	
Premiums receivable	66,952
Other receivables	32,110
Other assets	(2,579)
Increase in operating liabilities:	
Unpaid claims and claims adjustment expenses	1,102,832
Accounts payable	170,002
Advance premiums	157,501
Other liabilities	61,885
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 1,158,527

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. The Pool 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.

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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

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 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 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 under 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. 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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

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.

Investments

The Pool's investments with a maturity of more than one year at acquisition and non-money market investments are reported at fair value as determined by quoted market prices. The net change in the fair value of investments is recognized as a component of investment income.

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, 2010 was $75,000.

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, 2010, were $41,663.

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, 2010 was $2,081.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets (Continued)

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.

Unpaid Claims and Claims Adjustment Expenses

Unpaid claims and claims adjustment expenses are charged to operations as incurred. The Pool does not discount the liabilities for unpaid claims and claims adjustment expenses. Liabilities for unpaid claims and claims 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 are collected and will be earned in future periods 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, 2010, nonoperating revenue sources accounted for 40% 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 - INVESTMENTS

The Pool's investment policy was adopted by the Board of Directors in August 2009 and is designated to protect the Pool's capital, while providing liquidity for disbursement needs and maximizing investment returns. The Pool is invested in fixed income securities and mutual funds.

As of June 30, 2010, the Pool had the following investments and maturities:

Investment Type	Fair Value	Less than 1 Year	Over 1 Year
Mutual Funds	$ 9,366,860	$ 9,366,860	$ -
Corporate Bonds	4,979,979	3,637,426	1,342,553
Municipal Bonds	3,400,000	-	3,400,000
	$ 17,746,839	$ 13,004,286	$ 4,742,553

Interest Rate Risk

The Pool uses the duration method as a means of limiting its exposure to fair value losses arising from rising interest rates. The Pool's investment policy limits the duration of investments in fixed income securities to securities maturing no more than five years from the date of purchase. All corporate bonds have a maturity within five years of the date of purchase; however, the municipal bond category contains variable rate demand notes ("VRDN"). These issues can be put back to the issuers with a seven day notice. This liquidity provision is backed by letters of credit from independent banks, assuring the Pool can redeem the bonds at par plus accrued interest within the seven day period. The legal maturity dates for the VRDN's are more than five years from date of purchase.

Credit Risk

The Pool's investment policy requires that all investments in corporate bonds maintain a rating of BBB or better by Standard and Poor's, or Baa2 or better by Moody's. Investments in state and local government obligations must maintain a MIG1, SPI, AAA or Aaa from the applicable rating agencies.

The ratings of the corporate and municipal bonds are presented in the following table:

Type of Bonds	S&P	Moody	Market Value
Corporate	A	A2	$ 534,573
	BBB+	Baa1	203,304
	BBB	Baa2	202,548
	A	A1	269,315
	A-	Baa2	203,462
	A-	A3	273,465
	A-	A2	263,123
	AA+	Aa2	151,956
	BBB+	Baa1	200,784
	A+	Aa3	202,664

NOTE 2 - INVESTMENTS (CONTINUED)

Credit Risk (Continued)

Type of Bonds		S&P	Moody	Market Value
		BBB+	A3	$ 260,535
		BBB	Baa2	259,255
		A	A2	510,973
		BBB+	Baa1	207,158
		BBB+	A3	255,118
		BBB	Baa2	520,442
		A	A3	205,412
		BBB+	Baa1	255,892
	Total Corporate			4,979,979
Municipal		AA/A-1+	Aa3	700,000
		AA-/A-1	WR	600,000
		AA/-1+	Aa2	700,000
		N/R	Aa1	700,000
		AAA/A-1+	Aaa	700,000
	Total Municipal			3,400,000
	Total			$ 8,379,979

NOTE 3 - CASH AND CASH EQUIVALENTS

The Pool maintains its cash balances in a federally insured banking institution. The Pool has cash balances at June 30, 2010 as follows:

	Carrying Amount	Bank Balance
Cash	$ 3,128,347	$ 3,882,241
Money market account at bank	2,630,161	2,630,161
Money market fund	11,607,776	11,607,776
	$17,366,284	$18,120,178

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.

NOTE 3 - CASH AND CASH EQUIVALENTS (CONTINUED)

At June 30, 2010, $250,000 of the bank balance was covered by FDIC insurance. 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 4 - CHANGE IN CAPITAL ASSETS

	Beginning Balance	Additions and Transfers	Deletions and Transfers	Ending Balance
Depreciable Capital Assets:				
Furniture and equipment	$ 12,623	$ -	$ -	$ 12,623
Accumulated depreciation	(2,311)	(2,081)	-	(4,392)
Net	$ 10,312	$ (2,081)	$ -	$ 8,231

NOTE 5 - LIABILITY FOR UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES

Activity in the liability for unpaid claims is summarized as follows:

Balance at July 1		$ 2,441,306
Incurred related to:		
Current year		15,473,911
Prior years		(1,760,182)
	Total incurred	13,713,729
Paid related to:		
Current year		11,944,083
Prior years		666,814
	Total paid	12,610,897
Balance at June 30		$ 3,544,138

NOTE 5 - LIABILITY FOR UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES (CONTINUED)

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.

NOTE 6 - 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 2010. 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, 2010, there were no net reinsurance receivables and prepaids.

The effect of reinsurance on premiums written and earned for the year ended June 30, 2010 is as follows:

	Written	Earned
Direct	$15,795,228	$15,795,228
Ceded	(471,984)	(471,984)
Net	$15,323,244	$15,323,244

There were no recoveries related to the reinsurance contracts that were deducted from claims expense for 2010.

NOTE 7 - LEASE COMMITMENTS

The Pool has entered into an operating lease for its office space. The lease expires December 31, 2013. Lease expense for the year ended June 30, 2010 was $17,766. Future minimum rental payments at June 30, 2010 are:

2011	$ 18,042
2012	18,584
2013	9,810
	$ 46,436

NOTE 8 - 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, 2010, the Pool's contributions to the plan were $11,494 based on eligible salaries of $191,570.

NOTE 9 - PUBLIC FUNDING

The Pool's major source of nonoperating revenue was funding from the State of North Carolina based on premium taxes assessed on health insurance policies issued throughout the State.

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. Without continued future state revenues, there exists the possibility that premium revenue will not be sufficient in future years to cover all claims and other expenses of the Pool.

NOTE 10 - RISK MANAGMENT

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.

REQUIRED SUPPLEMENTARY INFORMATION

The table below illustrates how the Pool's earned premiums (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Pool as of the end of each of the two years since inception. The rows of the table are defined as follows: (1) This line shows that the total of each fiscal year's earned and ceded premiums, administrative fees, other operating, and investment revenues. (2) This line shows each fiscal year's other operating costs of the Pool including overhead and unallocated claims expenses not allocable to individual claims. (3) This line shows the Pool's incurred and ceded claims and allocated claims adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage occurred (called accident year). (4) These lines show the cumulative amounts paid as of the end of successive years for each accident year. (5) This line shows the most current estimate of losses assumed by reinsurers for each accident year. (6) These lines show how each accident year's incurred claims increased or decreased as of the end of successive years. This annual re-estimate results from new information received on known claims, re-evaluation of existing information on known claims, as well as emergence of new claims previously known. (7) This line compares the latest re-estimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual accident years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature accident years. The columns of the table show data for successive accident years.

		2010	2009
1) Premiums, investment, and other revenues			
Premiums earned, net		$ 15,323,244	$ 2,607,553
State and federal aid revenue		10,453,118	22,871,880
Investment income		342,675	212,195
Net earned		26,119,037	25,691,628
2) Unallocated expenses		2,208,772	1,220,826
3) Estimated incurred claims and allocated claims adjustment expenses, end of accident year:			
Incurred		15,473,911	4,337,287
Ceded		-	-
	Net incurred	15,473,911	4,337,287
4) Paid (cumulative) claims and allocated claims adjustment expense as of:			
End of accident year		11,944,083	1,895,981
One year later		-	2,562,795
5) Reestimated ceded claims and expenses		-	-
6) Reestimated net incurred claims and allocated claims adjustment expense:			
End of accident year		15,473,911	4,337,287
One year later		-	2,667,105

	2010	2009
7) Increase (decrease) in estimated net incurred claims and allocated claims adjustment expense from end of accident year	$ -	$ (1,760,182)

Note: Only two years of information is presented as the Pool began operations in 2009. The above financial data is summarized for individual contract periods. Subsequent premium and related expense adjustments and reserve developments are recorded in the year incurred for fiscal year financial reporting but are included in the applicable contract year for purposes of the above schedule. Accordingly, components of change in net assets as determined on a contract-year basis will differ from that included in the Pool's fiscal year financial statements.

SUPPLEMENTAL INFORMATION

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a/ INCLUSIVE HEALTH
SCHEDULE OF OTHER EXPENSES
June 30, 2010

CONTRACTUAL EXPENSES		
Accounting		$ 48,543
Actuarial services		64,079
Administrative services		1,111,283
Audit services		27,936
Communication/Outreach		143,983
Legal		25,806
PBM procurement		35,644
Producer compensation		220,550
Other contractual expenses		13,897
	TOTAL CONTRACTUAL EXPENSES	1,691,721
PERSONNEL EXPENSES		
Insurance		10,712
Payroll taxes		12,209
Retirement plan contribution		13,349
Salaries		177,540
Travel		13,141
Other personnel expenses		10,449
	TOTAL PERSONNEL EXPENSES	237,400
GENERAL EXPENSES		
Bad debts		(25,000)
Insurance		15,574
Postage and delivery		8,266
Rent		17,766
Telephone		8,205
Other general expenses		62,840
	TOTAL GENERAL EXPENSES	87,651
	TOTAL OTHER EXPENSES	$ 2,016,772

DIXON HUGHES PLLC
Certified Public Accountants and Advisors

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, 2010, and have issued our report thereon dated February 22, 2011. 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.

Our consideration of internal control over financial reporting 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 might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described below, we identified certain deficiencies in internal control over financial reporting that we collectively consider to be a material weakness.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Pool's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in internal control to be a material weakness.

Improved Coordination between Management and Third-Party Administrators

The Pool outsources the majority of daily functions to various external parties. During the course of the audit, we noted that the Pool's external accountant ("accountant") used several reports from various third-party administrators ("TPA") to record premiums and

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claims. There appears to be a lack of communication between the TPAs and the accountant. This lack of communication has lead to an immaterial difference between the reports provided by the TPAs and the amounts recorded as premiums earned. We suggest management facilitate regular meetings with all external parties to ensure all information is being recorded as intended and that all parties have access to all relevant information needed to perform their duties.

Management's Response: The difference in how premiums are recorded on the financial statements versus how CoreSource reflects them stems in part from differing business requirements. CoreSource tracks premiums on a cash basis to manage the collections process while the financials are maintained on an accrual basis for reporting purposes. In addition, more work needs to be done by both parties in reconciling their numbers with one another on an ongoing basis.

Despite little to no financial impact in the current year, management does recognize the opportunity for improved coordination that exists between the accountant and CoreSource/NGS premium collections. As we grow, better management and coordination will be imperative, due to the volume of transactions that will be handled by these various parties. To help improve this coordination, management will facilitate quarterly meetings to discuss any operating issues or changes and adopt best practices going forward

Allowance for Uncollectable Premiums Procedure

During the course of the audit, we noted that the Pool does not have a formalized procedure to compute an allowance for uncollectable premiums receivable. We recommend that management work with their TPAs to determine a consistent approach to compute an estimate for uncollectable premiums receivable. This approach should also include proper write-offs of premium receivables when it become evident they are uncollectible.

Management's Response: In its first two years, Inclusive Health's practice has been to review the reserve for bad debts at the end of the year and to adjust accordingly. This was what happened prior to finalizing the 2008-2009 financials in a conversation between the Vice President at NGS CoreSource and the Executive Director and resulted in a year end adjustment. While the pool was developing a track record on which to base such estimates, this seemed the best practice.

Due to a lack of history, management has not developed a best practice. However, premiums receivable has been relatively low and as a result the need for a set procedure was not evident. However, now that our book of business is starting to season and we are developing a track record for collections, management with the assistance of CoreSource will develop a best practice plan to present to the Finance Committee at its April meeting on how to monitor this account and adjust as necessary.

Proper Accounting for Investments

During the course of the audit, we noted that Pool's investments were not recorded at fair value. Per *Governmental Accounting Standards Board* guidance, all investments should be reported at fair value in their basic financial statements. All investment income, including changes in fair value should be recognized as revenue in the operating statement. We suggest that changes in fair value be recorded through investment income in the Statement of Revenues, Expenses, and Change in Net Assets, and an adjustment to the value of the investment on the Statement of Net Assets.

Management's Response: To ensure that the final audited financial statements reflect the changes in fair market value that occurred over the fiscal year accurately while eliminating temporary fluctuations in investment activity that may distort interim reporting, management will develop a procedure to record market value fluctuations on our investment holdings at least annually. If the financial markets have significant variances throughout the year, management will consider the need to adjust to capture those fluctuations on a more frequent basis.

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 February 22, 2011.

Pool management's response to the material weakness in internal control is described above. We did not audit their response and, accordingly, we express no opinion on it.

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.

Dixon Hughes PLLC

February 22, 2011