

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

Financial Statements
Years Ended June 30, 2012 and 2011

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

Beth A. Wood, CPA
State Auditor



DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

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

Table of Contents

	<u>Page No.</u>
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Statements of Net Assets.....	8
Statements of Revenues, Expenses and Changes in Net Assets	9
Statements of Cash Flows	10
Notes to Financial Statements	11
Required Supplementary Information	
Four-Year Claims Development Information (Unaudited).....	24
Other Financial Information	
Schedules of Other Expenses.....	26
Statement of Net Assets by Program as of June 30, 2012	27
Statement of Revenues, Expenses and Changes in Net Assets by Program for the Year-Ended June 30, 2012	28
Independent Auditors' 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 <i>Government Auditing Standards</i>	29

INDEPENDENT AUDITORS' 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 Statements 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, 2012 and 2011, and the related Statements of Revenues, Expenses and Changes in Net Assets, and Cash Flows for the years then ended. These basic financial statements are the responsibility of the Pool's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits 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 audits to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Pool as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years 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 October 10, 2012, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 and the supplemental schedule of four-year claims development information on pages 24 and 25 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the Pool, taken as a whole. The Schedule of Other Expenses and the Statements of Net Assets by Programs in the accompanying supplementary information are presented for purposes of additional analysis, and are not a required part of the basic financial statements of the Pool. Such information is the responsibility of management, and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Dixon Hughes Goodman LLP

October 10, 2012

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012 and 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 years ended June 30, 2012 and 2011. 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 who 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:

Statements 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.

Statements 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.

Statements 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 (decrease) in cash and cash equivalents for the fiscal year. Due to timing differences associated with accrual accounting, net cash provided (used) 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.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012 and 2011

FINANCIAL SUMMARY

The following table summarizes the financial position of the Pool at June 30, 2012 and 2011, respectively:

Summary of Net Assets

	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 17,246,803	\$ 29,858,124
Fixed-income and equity securities	20,646,890	13,755,239
Other assets	7,469,034	3,064,993
Capital assets	<u>4,577</u>	<u>6,150</u>
Total assets	<u>45,367,304</u>	<u>46,684,506</u>
Liabilities		
	<u>17,073,012</u>	<u>9,356,623</u>
Net assets		
Invested in capital assets	4,577	6,150
Restricted	-	1,146,864
Unrestricted	<u>28,289,715</u>	<u>36,174,869</u>
Total	<u>\$ 28,294,292</u>	<u>\$ 37,327,883</u>

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 are included in other assets. The decrease in total assets of \$1,317,202 from 2011 to 2012 was driven by a decrease of \$12,611,321 in cash and cash equivalents and an increase of \$6,891,651 in fixed-income and equity securities. Other Assets include accrued pharmaceutical rebates, which increased \$719,975 as a result of increased pharmaceutical claims expense largely due to increased enrollment in both the State and Federal Pool; Grants Receivable, which increased \$3,119,028 primarily due to the timing of drawdowns of the HHS grant receivable; and prepaid expenses that increased by \$321,970 because of a payment for the July 2012 administrative fee, and small changes in prepaid insurance and rent. The decrease in cash and cash equivalents resulted from the transfer of assets for the purchase of investments held in the investment account and total cash expenses for 2012 exceeding total cash revenues.

Total Liabilities

The most significant components of the Pool's liabilities are unpaid claims and claims adjustment expenses, which totaled \$15,289,134 in 2012. That represents an increase of \$7,561,047 over 2011. The increase is commensurate with the increased enrollment and claims activity in 2012 and the addition of the increased operations of the Federal Risk Pool.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012 and 2011

FINANCIAL SUMMARY (Continued)

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>2012</u>	<u>2011</u>
Operating revenues		
Premiums earned	\$ 53,765,104	\$ 33,102,921
Total operating revenues	<u>53,765,104</u>	<u>33,102,921</u>
Operating expenses		
Claims expenses	73,741,586	37,923,445
Contractual expenses	7,953,650	4,217,617
Personnel expenses	375,881	348,693
General expenses	<u>186,860</u>	<u>82,229</u>
Total operating expenses	<u>82,257,977</u>	<u>42,571,984</u>
Operating loss	<u>(28,492,873)</u>	<u>(9,469,063)</u>
Nonoperating revenues		
State aid	3,855,353	6,581,804
Federal aid	15,416,035	7,923,936
Investment	<u>187,894</u>	<u>466,926</u>
Total nonoperating revenues	<u>19,459,282</u>	<u>14,972,666</u>
Change in net assets	(9,033,591)	5,503,603
Net assets - beginning of year	<u>37,327,883</u>	<u>31,824,280</u>
Net assets, end of year	<u>\$ 28,294,292</u>	<u>\$ 37,327,883</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012 and 2011

RESULTS OF OPERATIONS

Revenues

Total revenues increased \$25,148,799 or 52% from \$48,075,587 at June 30, 2011 to \$73,224,386 at June 30, 2012. This was driven by an increase in operating revenues of \$20,662,183, and an increase in nonoperating revenues of \$4,486,616. The increase of operating revenue was comprised solely of earned premiums, which increased commensurate with the state and federal Pool's increased enrollment in 2012. The increase in nonoperating revenues was comprised of the following key components, a decrease in premium tax revenue from the North Carolina Department of Insurance of \$2,726,451, an increase in Federal Aid for State Pool members of \$1,101,212, and an increase in Federal Pool HHS grant revenue of \$6,390,887 as a result of the increased enrollment and claims from operation of the Federal Risk Pool. In addition, nonoperating revenues attributed to investment income decreased by \$279,028 due to a shortening of the investment horizon with the approach of the planned pool shutdown in 2013 and primarily as a result of an increase of unrealized losses of \$202,106.

Expenses

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

Operating expenses totaled \$82,257,977 in 2012, representing an increase of \$39,685,993 over the prior year. The operating loss increased by \$19,023,810 to \$28,492,873. The increase in operating expenses is comprised of two key components: an increase in claims expenses of \$35,818,141 and an increase in contractual expenses of 3,736,033, both of which are related to increased enrollment, and an increase in medical claims payments and administration fees.

Future Conditions and Facts

The rate of Inclusive Health-State Option net enrollment growth is showing some signs of weakening as we enter the 2012-2013 fiscal year. Premium rate increases introduced on July 1, 2012 appear to have contributed to an increase in member terminations in the first few months of the new fiscal year. At the same time, the State Option has benefitted over time from a woodwork effect of the advertising efforts for the Federal Option. It is unclear how the discontinuation of these ads will impact State Option enrollment.

The medical loss ratio has been trending upward over time due, in part; to lower than expected state premium tax revenues. The Pool's Medicare rates continue to have a dampening effect on medical claims costs, and the premium rate increase should help offset this historical medical loss ratio trend increase. However, pharmacy claims that are paid with commercial rates have and will continue to be more inflationary. The overall impact that we expect to see is a steady decline in the Net Asset balance that started in the last fiscal year. In addition, we do not anticipate a significant increase in state insurance premium tax revenue payments due to the continuing impact of the economy on insurance sales and premium collections. As a result, the Pool will need to continue to closely monitor the long-term impact on Net Assets and the ability of the Pool to cover its expenses through the end of its expected life in December 2013.

**THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012 and 2011**

RESULTS OF OPERATIONS (Continued)

Future Conditions and Facts (Continued)

Funding for Inclusive Health – Federal Option includes a significant portion of federal funds from the Affordable Care Act. Due to lower than projected enrollment and claims expenses, the federal pool has not used as much of its original federal allocation as expected. We anticipate that the federal government will reduce that allocation to offset the higher than expected claims costs in almost every other PCIP plan. It is also unclear whether federal debt reduction negotiations may place some of that funding at risk, as Congress is forced to sequester expenditures to meet negotiated reduction targets. The outcome of that is contingent on that process which is playing out this fall.

Both options continue to proceed toward December 2013 with an eye on the Affordable Care Act implementation timetable. It is unclear what this transition's impact will be on Pool enrollment between now and then. Both options expect to transition their members to the new health insurance exchange as of January 2014.

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
STATEMENTS OF NET ASSETS
June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,182,552	\$ 26,693,166
Fixed-income securities	16,155,218	1,000,388
Equity securities	1,267,074	5,934,675
Accrued interest	113,553	97,058
Premiums receivable, net of allowance of \$30,000 and \$2,500 in 2012 and 2011, respectively	32,063	2,265
Grants receivable	1,233,645	1,099,422
Rebates receivable	1,342,477	841,972
Experience rated refund receivable	189,500	-
Other assets	389,337	248,400
Restricted assets:		
Cash and cash equivalents	1,064,251	3,164,958
Premium receivable, net of allowance of \$10,000 and \$2,500 in 2012 and 2011, respectively	10,063	2,788
Grants receivable	3,664,749	679,944
Rebates receivable	312,614	93,144
Other assets	181,033	-
Total current assets	<u>42,138,129</u>	<u>39,858,180</u>
Noncurrent assets:		
Fixed-income securities	3,224,598	6,820,176
Capital assets, net of accumulated depreciation of \$8,560 and \$6,473 in 2012 and 2011, respectively	4,577	6,150
Total noncurrent assets	<u>3,229,175</u>	<u>6,826,326</u>
TOTAL ASSETS	<u>\$ 45,367,304</u>	<u>\$ 46,684,506</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Current liabilities:		
Unpaid claims and claims adjustment expenses	\$ 15,289,134	\$ 7,728,087
Accounts payable	204,227	39,738
Unearned federal grant revenue:		
Obligated unearned grant revenue	849,546	970,284
Unobligated unearned grant revenue	384,099	129,138
Advance premiums	333,452	466,597
Unapplied premiums	2,076	2,855
Other liabilities	10,478	19,924
Total current liabilities	<u>17,073,012</u>	<u>9,356,623</u>
NET ASSETS		
Invested in capital assets	4,577	6,150
Restricted	-	1,146,864
Unrestricted	<u>28,289,715</u>	<u>36,174,869</u>
Total net assets	<u>28,294,292</u>	<u>37,327,883</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 45,367,304</u>	<u>\$ 46,684,506</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES		
Premiums earned, net	\$ 53,765,104	\$ 33,102,921
TOTAL OPERATING REVENUES	<u>53,765,104</u>	<u>33,102,921</u>
OPERATING EXPENSES		
Claims expense	73,741,586	37,923,445
Contractual expenses	7,953,650	4,217,617
Personnel expenses	375,881	348,693
General expenses	186,860	82,229
TOTAL OPERATING EXPENSES	<u>82,257,977</u>	<u>42,571,984</u>
NET OPERATING LOSS	<u>(28,492,873)</u>	<u>(9,469,063)</u>
NONOPERATING REVENUES		
State aid	3,855,353	6,581,804
Federal aid	15,416,035	7,923,936
Investment income	187,894	466,926
TOTAL NONOPERATING REVENUES	<u>19,459,282</u>	<u>14,972,666</u>
CHANGE IN NET ASSETS	(9,033,591)	5,503,603
NET ASSETS, BEGINNING OF YEAR	<u>37,327,883</u>	<u>31,824,280</u>
NET ASSETS, END OF YEAR	<u>\$ 28,294,292</u>	<u>\$ 37,327,883</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Premiums received	\$ 53,393,520	\$ 32,867,343
Claims paid	(66,896,301)	(34,670,754)
Payments to employees and benefits	(378,453)	(347,153)
Payments to vendors and suppliers	<u>(8,295,904)</u>	<u>(4,574,951)</u>
NET CASH USED BY OPERATING ACTIVITIES	<u>(22,177,138)</u>	<u>(6,725,515)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State and federal aid received	<u>16,286,583</u>	<u>14,758,529</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of fixed-income securities	(28,719,784)	(7,522,094)
Purchases of equity securities	-	(1,800,000)
Proceeds from the sale of fixed-income and equity securities	21,589,285	13,200,049
Investment income received	<u>409,733</u>	<u>580,871</u>
NET CASH (USED) PROVIDED BY INVESTING ACTIVITIES	<u>(6,720,766)</u>	<u>4,458,826</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(12,611,321)	12,491,840
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>29,858,124</u>	<u>17,366,284</u>
TOTAL ASSETS END OF YEAR	<u>\$ 17,246,803</u>	<u>\$ 29,858,124</u>
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Net operating loss	\$ (28,492,873)	\$ (9,469,063)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Bad debt expense (recoveries)	35,000	(70,000)
Depreciation	2,087	2,081
Decrease (increase) in operating assets:		
Premiums receivable	(72,073)	76,546
Rebates receivable	(719,975)	(829,139)
Experience rated refund receivable	(189,500)	-
Other assets	(321,970)	(228,299)
Increase (decrease) in operating liabilities:		
Unpaid claims and claims adjustment expenses	7,561,047	4,183,949
Accounts payable	164,489	(154,864)
Advance premiums	(133,145)	(120,856)
Unapplied premiums	(779)	(122,333)
Other liabilities	<u>(9,446)</u>	<u>6,463</u>
NET CASH USED BY OPERATING ACTIVITIES	<u>\$ (22,177,138)</u>	<u>\$ (6,725,515)</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS:		
Cash and cash equivalents	\$ 16,182,552	\$ 26,693,166
Restricted cash and cash equivalents	<u>1,064,251</u>	<u>3,164,958</u>
	<u>\$ 17,246,803</u>	<u>\$ 29,858,124</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

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 who 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.

In July 2007, the Pool contracted with the Centers for Medicare and Medicaid Services (CMS) to administer the newly established Pre-Existing Condition Insurance Plan (PCIP) or federal risk pool that was the first major initiative under the Affordable Care Act. This is a separate pool with strict rules on non-commingling of funds that the Pool runs parallel to the state high risk pool. In the accompanying Statements of Net Assets, assets associated with the federal pool have been presented as restricted assets. Funding is provided by the federal government to supplement member premiums. As opposed to immediate coverage from the state pool, eligibility is limited to individuals who have been without creditable coverage for at least six months.

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 NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Reporting Entity (Continued)

The Pool is governed by a 12-member board of directors. 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 of directors 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 accounting principles generally accepted in the United States of America (GAAP) 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
- Statements of Net Assets
- Statements of Revenues, Expenses and Changes in Net Assets
- Statements of Cash Flows
- Notes to Financial Statements

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation (Continued)

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, 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.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP 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 represent the Pool's total investment in capital assets, restricted assets, which include any net assets associated with the operation of the federal pool, and unrestricted net assets, which include all resources not invested in capital assets or restricted.

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.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

The Pool's investments in fixed-income securities and equity securities are reported at estimated fair value as determined by quoted market prices, where available. The net change in the estimated fair value of investments, realized gains and losses, and interest and dividend income is recognized as investment income in the accompanying Statements of Revenues, Expenses, and Changes in Net Assets.

The Pool's investments with a maturity greater than one year as of the balance sheet date are classified as noncurrent assets in the accompanying Statements of Net Assets, whereas, fixed-income securities with maturities of less than one year as of the balance sheet date and equity securities are classified as current assets in the accompanying Statements of Net Assets.

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, creditworthiness of the member, and historical payments. The allowance for doubtful accounts at June 30, 2012 and 2011 was \$40,000 and \$5,000, respectively.

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. Premiums receivable net of allowance for doubtful accounts at June 30, 2012 and 2011 was \$42,126 and \$5,053, respectively.

Grants Receivable

The Pool receives funding in the form of grants from federal government agencies as discussed in Note 9. The Pool accrues grant revenue pursuant to the respective agreements. Accrued but not received grant revenue is recorded as grants receivable in the accompanying Statements of Net Assets.

Rebates Receivable

The Pool provides pharmaceutical coverage to its policyholders. As a result, some of the pharmaceutical claim payments are for brand-name drugs. The pharmaceutical benefit manager (PBM) receives rebates from the pharmacies when some of these drugs are purchased. Pursuant to the service agreement between the Pool and the PBM, these rebates are passed on to the Pool. There is currently a two-quarter lag in the remittance of the rebates to the Pool. Due to the lag in receipt of these funds, the Pool estimates the uncollected rebates and records this amount as rebates receivable in the accompanying Statements of Net Assets.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets

Capital assets are recorded at their purchase price 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 varies between five and seven years. Depreciation expense for the years ended June 30, 2012 and 2011 was \$2,087 and \$2,081, respectively.

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 realized profit or loss at disposition is reflected in the accompanying Statements 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 actuarially 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.

Unearned Federal Grant Revenue

The Pool receives funding from CMS to provide premium subsidies for qualified applicants. The obligated unearned grant revenue represents the Pool's estimate for the amount of premium subsidy payments current policyholders would receive through the end of the grant year, December 31, 2012. The unobligated unearned grant revenue is the difference between the amount obligated for current policyholders and the maximum funds available through December 31, 2012, per the grant agreement.

Revenue Recognition

Premiums are generally recognized as revenue during the month coverage is afforded to the member. The portion of premiums that are collected in advance of their effective dates are deferred and reported as advance premiums in the accompanying statements of net assets.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition (Continued)

The Pool classifies its revenues as operating or nonoperating in the accompanying Statements 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 investment income and public funding sources of the State of North Carolina and the federal government. For the years ended June 30, 2012 and 2011, nonoperating revenue sources accounted for 27% and 31% of all revenues, respectively.

Reinsurance

The Pool limits the maximum net loss that can arise from large claims 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; however, the Pool remains liable to the insureds, should the reinsurer not meet its obligations. Amounts recoverable from the reinsurer are estimated and recognized in a manner consistent with the claim 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. The Pool had no unrelated business income during the years ended June 30, 2012 and 2011.

Prior Period Reclassification Adjustment

Certain amounts in the 2011 basic financial statements have been adjusted to conform to the 2012 presentation. During the current year, it was determined that Federal Pool assets and net assets are restricted, so Federal Pool assets of \$3,940,534 and net assets of \$1,146,864 as of June 30, 2011 have been reclassified as restricted in the 2011 Statement of Net Assets. Management deemed these adjustments immaterial to the financial statements as a whole, but elected to retrospectively apply restrictive classification to the prior year amounts included in these financial statements.

Subsequent Events

The Pool evaluated the recognition and disclosure of subsequent events for its financial statements through October 10, 2012, the date the financial statements were available to be issued. There were no subsequent events through the evaluation date that merit disclosure or would have a material effect on the financial condition of the Pool.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

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, 2012 and 2011, the Pool had the following investments and maturities:

	2012			2011
	Estimated Fair Value	Less than 1 Year	Over 1 Year	Estimated Fair Value
<u>Fixed-Income Securities</u>				
Certificates of deposit	\$ 7,841,625	\$ 5,842,000	\$ 1,999,625	\$ 2,749,625
Government agency bonds	4,061,340	4,061,340	-	-
Corporate bonds	6,364,786	5,894,813	469,973	4,706,509
Municipal bonds	<u>1,112,065</u>	<u>357,065</u>	<u>755,000</u>	<u>364,430</u>
	<u>\$ 19,379,816</u>	<u>\$ 16,155,218</u>	<u>\$ 3,224,598</u>	<u>\$ 7,820,564</u>

The Pool is invested in mutual funds with an estimated fair value of \$1,267,074 and \$5,934,675 as of June 30, 2012 and 2011, respectively. These amounts are classified as equity securities in the accompanying Statements of Net Assets.

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.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 2 - INVESTMENTS (Continued)

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 government agency, corporate and municipal bonds as of June 30, 2012 are as follows:

<u>Type of Bonds</u>	<u>S&P</u>	<u>Moody</u>	<u>Market Value</u>
Government agency	AA+	Aaa	\$ <u>4,061,340</u>
Corporate	AA+	A1	258,443
	A+	A2	509,753
	A	A2	1,301,891
	A	A1	258,553
	A-	A1	204,316
	A-	A2	257,175
	A-	A3	563,869
	A-	Baa2	252,558
	A-	NR	256,920
	BBB+	A3	255,050
	BBB+	Baa1	972,821
	BBB	Baa1	509,650
	BBB	Baa2	<u>763,787</u>
Total corporate			<u>6,364,786</u>
Municipal	AA-	Aa2	1,107,065
	NR	Aa3	<u>5,000</u>
Total municipal			<u>1,112,065</u>
Total			<u>\$ 11,538,191</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 - CASH AND CASH EQUIVALENTS

The Pool maintains its cash balances in a federally insured banking institution. The Pool had cash balances at June 30, 2012 as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash deposits	\$ 8,703,152	\$ 10,842,317
Money market fund	581,605	581,605
Money market account at bank	362,046	362,046
Money market repurchase agreement sweep	<u>7,600,000</u>	<u>7,600,000</u>
	<u>\$ 17,246,803</u>	<u>\$ 19,385,968</u>

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.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, noninterest-bearing bank accounts at all FDIC-insured institutions will be fully insured through December 31, 2012. Therefore, at June 30, 2012, the Pool's cash deposits are fully insured above the regular FDIC limit of \$250,000. The Pool mitigates its exposure to losses from these cash deposits by monitoring the financial stability of the financial institutions involved. In addition, the Pool had certificates of deposit with a bank and book balance of \$7,841,625 in a banking institution. At June 30, 2012, all certificates of deposit were covered by FDIC insurance.

Interest rate risk is the risk that changes in interest rates will adversely affect the estimated 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

	<u>Beginning Balance</u>	<u>Additions and Transfers</u>	<u>Deletions and Transfers</u>	<u>Ending Balance</u>
Depreciable capital assets:				
Furniture and equipment	\$ 12,623	\$ 514	\$ -	\$ 13,137
Accumulated depreciation	<u>(6,473)</u>	<u>(2,087)</u>	<u>-</u>	<u>(8,560)</u>
Net	<u>\$ 6,150</u>	<u>\$ (1,573)</u>	<u>\$ -</u>	<u>\$ 4,577</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 5 - LIABILITY FOR UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES

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

	<u>2012</u>	<u>2011</u>
Balance at July 1	\$ <u>7,728,087</u>	\$ <u>3,544,138</u>
Incurred related to:		
Current year	77,797,309	40,594,343
Prior years	<u>(1,616,160)</u>	<u>(1,269,852)</u>
Total incurred	<u>76,181,149</u>	<u>39,324,491</u>
Paid related to:		
Current year	63,787,473	33,343,394
Prior years	<u>4,832,629</u>	<u>1,797,148</u>
Total paid	<u>68,620,102</u>	<u>35,140,542</u>
Balance at June 30	<u>\$ 15,289,134</u>	<u>\$ 7,728,087</u>

The total incurred claim and claim adjustment expenses above excludes pharmaceutical rebates earned of \$2,439,563 and \$1,401,046 for the years ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, pharmaceutical rebates received of \$1,176,534 and \$752,946, respectively, is excluded from the claim and claims adjustment expenses paid.

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. As a result of changes in estimates of insured events in prior years, the liability for unpaid claims and claim adjustment expenses decreased by \$1,616,160 in fiscal 2012 and \$1,269,852 in fiscal 2011.

NOTE 6 - REINSURANCE ACTIVITY

The Pool cedes a portion of its direct business to a reinsurance company. The Pool's reinsurance contracts provide medical excess of loss coverage on a calendar year basis. These reinsurance contracts do not relieve the Pool from its obligations to policyholders. Failure of the reinsurers to honor their obligations could result in losses to the Pool; consequently, allowances are established for amounts deemed uncollectible. No such allowances were considered necessary for 2012 or 2011. 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.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 6 - REINSURANCE ACTIVITY (Continued)

Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy. At June 30, 2012 and 2011, there were no reinsurance recoverables, funds held, reinsurance treaties, or "prepaids" from the reinsurance company except for an experience rated refund receivable. Based upon management's estimate, \$189,500 and \$0 was accrued as a receivable from the reinsurer as of June 30, 2012 and 2011, respectively. As a result of the experience rated refund estimate, ceded premiums written and earned was reduced by the same amount.

The reinsurance contract for the 2012 calendar year stipulates that the Pool retain a maximum of \$400,000 of coverage per covered person, subject to a 90% coinsurance. The liability to the reinsurer is also limited to \$540,000 per covered person, subject to a lifetime limit of \$1,000,000.

Under the 2011 reinsurance contract year, the Pool retains a maximum of \$300,000 of coverage per covered person, subject to a 90% coinsurance. The liability to the reinsurer is also limited to \$630,000 per covered person, subject to a lifetime limit of \$1,000,000.

The 2010 calendar year reinsurance contract, which provided coverage to the Pool during the first six months of the year ended June 30, 2011, provided the Pool retain a maximum of \$250,000 of coverage per covered person, subject to a 90% coinsurance. The liability to the reinsurer is also limited to \$675,000 per covered person, subject to a lifetime limit of \$1,000,000.

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

	<u>2012</u>		<u>2011</u>	
	<u>Written</u>	<u>Earned</u>	<u>Written</u>	<u>Earned</u>
Direct	\$ 54,244,347	\$ 54,244,347	\$ 33,820,238	\$ 33,820,238
Ceded	<u>(479,243)</u>	<u>(479,243)</u>	<u>(717,317)</u>	<u>(717,317)</u>
Net	<u>\$ 53,765,104</u>	<u>\$ 53,765,104</u>	<u>\$ 33,102,921</u>	<u>\$ 33,102,921</u>

There were recoveries related to claims incurred under the reinsurance contracts of \$0 and \$136,232, which were deducted from claims expense for 2012 and 2011, respectively.

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, 2012 was \$18,584. As of June 30, 2012, future minimum rental payments for the years ending June 30 are as follows:

2013	\$ 19,098
2014	<u>9,810</u>
	<u>\$ 28,908</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

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 years ended June 30, 2012 and 2011, the Pool's contributions to the plan were \$17,323 and \$16,221, based on eligible salaries of \$290,082 and \$270,347, respectively.

NOTE 9 - PUBLIC FUNDING

The State 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 and funding through the Department of Health and Human Services (HHS) to reimburse allowable expenses incurred to operate the high risk health pool.

It is uncertain as to the level of premium tax revenue that will be received in the future. General economic and insurance market conditions 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, premium revenue probably will not be sufficient in future years to cover all claims and other expenses of the Pool.

The State Pool also utilizes grant income from CMS to provide premium subsidies to applicants who qualify based on income. Future grant income is dependent upon annual reauthorization in the federal budget and thus is subject to uncertainty, given the current budgetary situation. As a result, estimated yearly options may differ from actual funding allowable from CMS. In 2012, the demand for premium subsidies by qualifying individuals exceeded the available CMS grant funding. In response, the Board of Directors approved a motion to provide discounted premiums to participants who would otherwise qualify for the CMS premium subsidy, subject to a maximum of 600 members per month. For the year ended June 30, 2012, this amounted to a reduction of earned premiums totaling \$684,268.

The Federal Pool is reimbursed by HHS for allowable and allocable administrative costs and claim costs in the development and operation of the Pool. Although the federal pool identified an initial per capita based allocation for North Carolina, this allocation is not guaranteed and is also subject to the federal budget process and to the reallocation to other states as needs require.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 10 - 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:

<u>Type of Loss</u>	<u>Method Managed</u>	<u>Risk of Loss Retained</u>
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 NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
FOUR-YEAR CLAIMS DEVELOPMENT INFORMATION (UNAUDITED)
June 30, 2012, 2011, 2010 and 2009

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 three years since inception. The rows of the table are defined as follows: 1) This line shows 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.

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
1) Premiums, investment, and other revenues:				
Premiums earned, net	\$ 2,607,553	\$ 15,323,244	\$ 33,102,921	\$ 53,765,104
State and federal aid revenue	22,871,880	10,453,118	14,505,740	19,271,388
Investment income	<u>212,195</u>	<u>342,675</u>	<u>466,926</u>	<u>187,894</u>
Net earned	<u>25,691,628</u>	<u>26,119,037</u>	<u>48,075,587</u>	<u>73,224,386</u>
2) Unallocated expenses	\$ 1,220,826	\$ 2,208,772	\$ 4,939,988	\$ 9,341,391
3) Estimated incurred claims and allocated claims adjustment expenses, end of accident year:				
Gross	\$ 4,337,287	\$ 15,473,911	\$ 40,730,575	\$ 77,797,309
Ceded	<u>-</u>	<u>-</u>	<u>(136,232)</u>	<u>-</u>
Net incurred	<u>4,337,287</u>	<u>15,473,911</u>	<u>40,594,343</u>	<u>77,797,309</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
FOUR-YEAR CLAIMS DEVELOPMENT INFORMATION (UNAUDITED)
June 30, 2012, 2011, 2010 and 2009

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
4) Paid (cumulative) claims and allocated claims adjustment expense as of:				
End of accident year	\$ 1,895,981	\$ 11,944,083	\$ 33,343,394	\$ 63,787,473
One year later	2,562,795	13,733,970	38,148,235	-
Two years later	2,570,056	13,761,642	-	-
Three years later	2,570,172	-	-	-
5) Re-estimated ceded claims and expenses	\$ -	\$ -	\$ 136,232	\$ -
6) Re-estimated net incurred claims and allocated claims adjustment expense:				
End of accident year	\$ 4,337,287	\$ 15,473,911	\$ 40,594,343	\$ 77,797,309
One year later	2,667,105	14,208,798	39,517,533	-
Two years later	2,662,366	13,761,642	-	-
Three years later	2,570,172	-	-	-
7) Decrease in estimated net incurred claims and allocated claims adjustment expense from end of accident year	\$ (1,767,115)	\$ (1,712,269)	\$ (1,076,810)	\$ -

Note: Only four years of information is presented for the Pool, which represents inception through June 30, 2012. 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 accompanying basic financial statements.

This audit required 300 audit hours at an approximate cost of \$42,000.

The cost represents 0.53% of the \$8 million of contract expenses subjected to the audit.

OTHER FINANCIAL INFORMATION

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
SCHEDULE OF OTHER EXPENSES
June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CONTRACTUAL EXPENSES		
Accounting	\$ 87,544	\$ 70,716
Actuarial services	87,565	64,214
Administrative services	5,475,145	2,642,723
Audit services	41,616	38,424
Communication/Outreach	990,676	661,071
Legal	41,116	45,028
PBM procurement	788	5,513
Producer compensation	1,229,200	686,789
Other contractual expenses	-	3,139
	<u>7,953,650</u>	<u>4,217,617</u>
PERSONNEL EXPENSES		
Insurance	24,143	20,373
Payroll taxes	21,378	19,505
Retirement plan contribution	17,323	16,221
Salaries	290,082	270,347
Travel	12,613	15,095
Other personnel expenses	10,342	7,152
	<u>375,881</u>	<u>348,693</u>
GENERAL EXPENSES		
Bad debts	35,000	(70,000)
Insurance	18,193	18,790
Postage and delivery	2,260	4,953
Rent	18,584	18,042
TOTAL ASSETS	8,168	9,893
Other general expenses	104,655	100,551
	<u>186,860</u>	<u>82,229</u>
	<u>186,860</u>	<u>82,229</u>
	<u>\$ 8,516,391</u>	<u>\$ 4,648,539</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENTS OF NET ASSETS BY PROGRAM
June 30, 2012

	<u>State</u>	<u>Federal</u>	<u>Eliminations</u>	<u>Total</u>
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 16,182,552	\$ -	\$ -	\$ 16,182,552
Fixed-income securities	16,155,218	-	-	16,155,218
Equity securities	1,267,074	-	-	1,267,074
Accrued interest	113,553	-	-	113,553
Premiums receivable, net of allowance of \$30,000	32,063	-	-	32,063
Grants receivable	1,233,645	-	-	1,233,645
Rebates receivable	1,342,477	-	-	1,342,477
Experience-rated refund receivable	189,500	-	-	189,500
Due from federal risk pool	19,450	-	(19,450)	-
Other assets	389,337	-	-	389,337
Restricted assets:				
Cash and cash equivalents	-	1,064,251	-	1,064,251
Other receivables, net of allowance of \$10,000	-	322,677	-	322,677
Grants receivable	-	3,664,749	-	3,664,749
Other assets	-	181,033	-	181,033
Total current assets	<u>36,924,869</u>	<u>5,232,710</u>	<u>(19,450)</u>	<u>42,138,129</u>
Noncurrent assets:				
Fixed-income securities	3,224,598	-	-	3,224,598
Capital assets, net of accumulated depreciation of \$8,560 and \$0 in State and Federal Pool, respectively	4,577	-	-	4,577
Total noncurrent assets	<u>3,229,175</u>	<u>-</u>	<u>-</u>	<u>3,229,175</u>
TOTAL ASSETS	<u>\$ 40,154,044</u>	<u>\$ 5,232,710</u>	<u>\$ (19,450)</u>	<u>\$ 45,367,304</u>
LIABILITIES AND NET ASSETS				
LIABILITIES				
Current liabilities:				
Unpaid claims and claims adjustment expenses	\$ 10,226,294	\$ 5,062,840	\$ -	\$ 15,289,134
Accounts payable	59,452	144,775	-	204,227
Unearned federal grant revenue:				
Obligated grant	849,546	-	-	849,546
Unobligated grant	384,099	-	-	384,099
Advance premiums	327,775	5,677	-	333,452
Unapplied premiums	2,266	(190)	-	2,076
Due to state risk pool	-	19,450	(19,450)	-
Other liabilities	10,320	158	-	10,478
Total current liabilities	<u>11,859,752</u>	<u>5,232,710</u>	<u>(19,450)</u>	<u>17,073,012</u>
NET ASSETS				
Invested in capital assets	4,577	-	-	4,577
Unrestricted	28,289,715	-	-	28,289,715
Total net assets	<u>28,294,292</u>	<u>-</u>	<u>-</u>	<u>28,294,292</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 40,154,044</u>	<u>\$ 5,232,710</u>	<u>\$ (19,450)</u>	<u>\$ 45,367,304</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS BY PROGRAM
Year Ended June 30, 2012

	<u>State</u>	<u>Federal</u>	<u>Eliminations</u>	<u>Total</u>
PREMIUMS EARNED, NET	\$ 42,817,745	\$ 10,947,359	\$ -	\$ 53,765,104
TOTAL OPERATING REVENUES	<u>42,817,745</u>	<u>10,947,359</u>	<u>-</u>	<u>53,765,104</u>
OPERATING EXPENSES				
Claims expense	51,602,125	22,139,461	-	73,741,586
Contractual expenses	4,913,565	3,040,085	-	7,953,650
Personnel expenses	187,679	188,202	-	375,881
General expenses	132,226	54,634	-	186,860
TOTAL OPERATING EXPENSES	<u>56,835,595</u>	<u>25,422,382</u>	<u>-</u>	<u>82,257,977</u>
NET OPERATING LOSS	<u>(14,017,850)</u>	<u>(14,475,023)</u>	<u>-</u>	<u>(28,492,873)</u>
NONOPERATING REVENUE				
State aid	3,855,353	-	-	3,855,353
Federal aid	2,087,876	13,328,159	-	15,416,035
Investment income	187,894	-	-	187,894
TOTAL NONOPERATING REVENUE	<u>6,131,123</u>	<u>13,328,159</u>	<u>-</u>	<u>19,459,282</u>
CHANGE IN NET ASSETS	<u>(7,886,727)</u>	<u>(1,146,864)</u>	<u>-</u>	<u>(9,033,591)</u>
NET ASSETS, BEGINNING OF YEAR	<u>36,181,019</u>	<u>1,146,864</u>	<u>-</u>	<u>37,327,883</u>
NET ASSETS, END OF YEAR	<u>\$ 28,294,292</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 28,294,292</u>

**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 basic 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, 2012, and have issued our report thereon dated October 10, 2012. 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

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

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

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 audits and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Dixon Hughes Goodman LLP

October 10, 2012