

**The North Carolina Health Insurance
Risk Pool, Inc. d/b/a Inclusive Health**
(A Component Unit of the
State of North Carolina)

Financial Statements
Years Ended June 30, 2013 and 2012

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
(A Component Unit of the State of North Carolina)**

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INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying 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, which are comprised of the Statements of Net Position as of June 30, 2013 and 2012, and the related Statements of Revenues, Expenses and Changes in Net Position, and Cash Flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Pool's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 *Governmental 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Dissolution of Pool

As discussed in Note 11 to the financial statements, actions were taken by the North Carolina General Assembly for a planned "Dissolution of the Pool." As planned, the Pool's insurance operations will sunset on January 1, 2014 and, after "Dissolution of the Pool," any remaining excess funds, after settlement of Pool obligations, will be distributed to the North Carolina General Fund. The financial statements do not include any adjustments that might result from the outcome of the Dissolution of the Pool. Our opinion is not modified with respect to this matter.

Change in Accounting Principle

As described in Note 1 to the financials, in 2013 the Pool adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). The primary financial reporting impact resulting from the implementation of GASB 63 in the accompanying financial statements was the renaming of "Net Assets" to "Net Position" and presentation of the Statements of Net Position. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the U.S. require that the Management's Discussion and Analysis on pages 4 through 8 and the Five-year Claims Development Information on pages 26 and 27 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.

Other Financial Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements of the Pool. The Schedule of Other Expenses, Statements of Net Position by Program, and the Statements of Revenues, Expenses, and Changes in Net Position by Program are presented for the purpose of additional analysis, and are not a required part of the basic financial statements.

The Schedule of Other Expenses, Statements of Net Position by Program, and the Statements of Revenues, Expenses, and Changes in Net Position by Program in the accompanying supplementary information are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 Schedule of Other Expenses, Statements of Net Position by Program, and the Statements of Revenues, Expenses, and Changes in Net Position by Program is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2013, 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* in considering the Pool's internal control over financial reporting and compliance.

Dixon Hughes Goodman LLP

October 15, 2013

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012

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, 2013 and 2012. 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 Position - This statement presents information reflecting the Pool's assets, liabilities and net position. Net position represents the amount of total assets less total liabilities. The statement of net position 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 Position - 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 position 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 position; therefore, a reconciliation is also provided.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012

FINANCIAL SUMMARY

The following table summarizes the financial position of the Pool at June 30, 2013 and 2012, respectively:

Summary of Net Position

	<u>2013</u>	<u>2012</u>
Assets		
Cash and cash equivalents	\$ 18,966,544	\$ 17,246,803
Fixed-income and equity securities	3,176,176	20,646,890
Other assets	10,462,964	7,469,034
Capital assets	<u>2,486</u>	<u>4,577</u>
Total assets	<u>\$ 32,608,170</u>	<u>\$ 45,367,304</u>
Liabilities	\$ 22,430,167	\$ 17,073,012
Net position		
Invested in capital assets	2,486	4,577
Unrestricted	<u>10,175,517</u>	<u>28,289,715</u>
Total liabilities and net position	<u>\$ 32,608,170</u>	<u>\$ 45,367,304</u>

Total Assets

Total assets consisted of a range of asset classes led by cash and cash equivalents, investments, and federal grant receivables, which are included in other assets. The decrease in total assets of \$12,759,134 from 2012 to 2013 was driven by a decrease of \$17,470,714 in fixed-income and equity securities. Other Assets include accrued pharmaceutical rebates, which increased \$476,703 as a result of increased pharmaceutical claims expense largely due to increased enrollment in both the State and Federal Pool; Grants Receivable, which increased \$3,361,689 primarily due to the timing of drawdowns of the HHS grant receivable; and prepaid expenses that decreased by \$525,447, because July administrative fees were not paid until the subsequent period; and small changes in prepaid insurance and rent. The increase in cash and cash equivalents is primary proceeds from investments sold during the year to fund operating expenses and to meet the Pool's short-term liquidity needs.

Total Liabilities

The most significant components of the Pool's liabilities are unpaid claims and claims adjustment expenses, which totaled \$20,997,208 in 2013. That represents an increase of \$5,708,074 over 2012. The increase is commensurate with the increased enrollment and claims activity in 2013 and the addition of the increased operations of the Federal Risk Pool.

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012

FINANCIAL SUMMARY (Continued)

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

Summary of Revenues, Expenses and Changes in Net Position

	<u>2013</u>	<u>2012</u>
Operating revenues		
Premiums earned	\$ <u>72,040,114</u>	\$ <u>53,765,104</u>
Total operating revenues	<u>72,040,114</u>	<u>53,765,104</u>
Operating expenses		
Claims expenses	112,504,239	73,741,586
Contractual expenses	8,989,348	7,953,650
Personnel expenses	536,581	375,881
General expenses	<u>129,512</u>	<u>186,860</u>
Total operating expenses	<u>122,159,680</u>	<u>82,257,977</u>
Operating loss	<u>(50,119,566)</u>	<u>(28,492,873)</u>
Nonoperating revenues		
State aid	3,299,344	3,855,353
Federal aid	28,584,214	15,416,035
Investment	<u>119,719</u>	<u>187,894</u>
Total nonoperating revenues	<u>32,003,277</u>	<u>19,459,282</u>
Change in net position	(18,116,289)	(9,033,591)
Net position - beginning of year	<u>28,294,292</u>	<u>37,327,883</u>
Net position, end of year	<u>\$ 10,178,003</u>	<u>\$ 28,294,292</u>

**THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012**

RESULTS OF OPERATIONS

Revenues

Total revenues increased \$30,819,005 or 42% from \$73,224,386 at June 30, 2012 to \$104,043,391 at June 30, 2013. This was driven by an increase in operating revenues of \$18,275,010, and an increase in nonoperating revenues of \$12,543,995. The increase of operating revenue was comprised solely of earned premiums, which increased commensurate with the state and federal Pool's increased enrollment in 2013. The increase in nonoperating revenues was comprised primarily of the following key components; an increase in Federal Pool HHS grant revenue of \$13,168,179 as a result of the increased enrollment, and claims from operation of the Federal Risk Pool offset by a loss of Premium Tax Revenue of \$556,009. In addition, nonoperating revenues attributed to investment income decreased by \$68,175, due to a shortening of the investment horizon with the approach of the planned pool shutdown in 2013, even with an increase of unrealized gain of \$258,149. There was a realized capital loss of \$435,526.

Expenses

Operating expenses are comprised of claims expense and the Pool's general and administrative expenses. Operating expenses totaled \$122,159,680 in 2013, representing an increase of \$39,901,703 over the prior year. The operating loss increased by \$21,626,693 to \$50,119,566. The increase in operating expenses is largely driven by an increase in claims expenses of \$38,762,653, which is related to increased enrollment, and an increase in medical claims payments.

Future Conditions and Facts

With the end of Inclusive Health coverage of federal Pool members on June 30, 2013, and state Pool members after December 31, 2013, Inclusive Health will cease operations and dissolve during 2014. Federal Pool coverage through the Pool ended six months earlier than expected after the federal government's decision to transition remaining members to their administration on July 1st. An estimated 95% of claims expenses runout is projected to be processed and paid by the end of September 2013. This same timeframe correlates with the end of monthly payments to CoreSource for third party administration which is the major source of administrative expense. State pool expense resolution are expected to follow the same patterns and timeframes by March of 2014.

The medical loss ratio has been trending upward over time due to potential adverse selection as lower cost members are the first to depart coverage. There is also the risk that, as coverage winds down, those remaining members will scramble to utilize their coverage before it expires. The Pool's Medicare rates continue to have a dampening effect on medical claims costs, and the premium rate increases implemented over the last two years 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.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2013 and 2012**

RESULTS OF OPERATIONS (Continued)

Future Conditions and Facts (Continued)

The overall impact that we expect to see is a continued steady decline in the Net Position balance. In addition, we do not know as of now whether the Pool will receive any state insurance premium tax revenue payment from collections during the previous state fiscal year, due to the continuing impact of the economy on insurance sales and premium collections. On the positive side, the Pool's decision to implement a series of cost cutting measures in early 2013 will continue to generate savings through the end of the fiscal year. The Pool also will have access to an additional \$2.1 million in federal grant funds after October 1, 2013, to help cover operational losses.

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
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
STATEMENTS OF NET POSITION
June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 18,061,878	\$ 16,182,552
Fixed-income securities	2,456,176	16,155,218
Equity securities	-	1,267,074
Accrued interest	11,240	113,553
Premiums receivable, net of allowance of \$25,000 and \$30,000 in 2013 and 2012, respectively	14,924	32,063
Grants receivable	797,142	1,233,645
Rebates receivable	1,583,582	1,342,477
Experience rated refund receivable	-	189,500
Other assets	31,461	389,337
Restricted assets:		
Cash and cash equivalents	904,666	1,064,251
Premium receivable, net of allowance of \$0 and \$10,000 in 2013 and 2012, respectively	-	10,063
Grants receivable	7,462,941	3,664,749
Rebates receivable	548,212	312,614
Other assets	13,462	181,033
Total current assets	<u>31,885,684</u>	<u>42,138,129</u>
Noncurrent assets:		
Fixed-income securities	720,000	3,224,598
Capital assets, net of accumulated depreciation of \$10,651 and \$8,560 in 2013 and 2012, respectively	2,486	4,577
Total noncurrent assets	<u>722,486</u>	<u>3,229,175</u>
TOTAL ASSETS	<u><u>\$ 32,608,170</u></u>	<u><u>\$ 45,367,304</u></u>
LIABILITIES AND NET POSITION		
LIABILITIES		
Current liabilities:		
Unpaid claims and claims adjustment expenses	\$ 20,997,208	\$ 15,289,134
Accounts payable	96,027	204,227
Unearned federal grant revenue:		
Obligated unearned grant revenue	740,553	849,546
Unobligated unearned grant revenue	56,589	384,099
Unearned state aid	143,660	-
Advance premiums	226,409	333,452
Unapplied premiums	4,256	2,076
Other liabilities	165,465	10,478
Total current liabilities	<u>22,430,167</u>	<u>17,073,012</u>
NET POSITION		
Net Investment in capital assets	2,486	4,577
Unrestricted	10,175,517	28,289,715
Total net position	<u>10,178,003</u>	<u>28,294,292</u>
TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 32,608,170</u></u>	<u><u>\$ 45,367,304</u></u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
OPERATING REVENUES		
Premiums earned, net	\$ 72,040,114	\$ 53,765,104
TOTAL OPERATING REVENUES	<u>72,040,114</u>	<u>53,765,104</u>
OPERATING EXPENSES		
Claims expense	112,504,239	73,741,586
Contractual expenses	8,989,348	7,953,650
Personnel expenses	536,581	375,881
General expenses	<u>129,512</u>	<u>186,860</u>
TOTAL OPERATING EXPENSES	<u>122,159,680</u>	<u>82,257,977</u>
NET OPERATING LOSS	<u>(50,119,566)</u>	<u>(28,492,873)</u>
NONOPERATING REVENUES (LOSSES)		
State aid	3,299,344	3,855,353
Federal aid	28,584,214	15,416,035
Investment income	555,245	240,615
Realized capital losses	<u>(435,526)</u>	<u>(52,721)</u>
TOTAL NONOPERATING REVENUES, NET	<u>32,003,277</u>	<u>19,459,282</u>
DECREASE IN NET POSITION	(18,116,289)	(9,033,591)
NET POSITION, BEGINNING OF YEAR	<u>28,294,292</u>	<u>37,327,883</u>
NET POSITION, END OF YEAR	<u>\$ 10,178,003</u>	<u>\$ 28,294,292</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Premiums received	\$ 72,162,102	\$ 53,393,520
Claims paid	(107,261,945)	(66,896,301)
Payments to employees and benefits	(402,686)	(378,453)
Payments to vendors and suppliers	(8,699,508)	(8,295,904)
	<u>(44,202,037)</u>	<u>(22,177,138)</u>
NET CASH USED BY OPERATING ACTIVITIES		
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State and federal aid received	28,229,026	16,286,583
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of fixed-income securities	(8,019)	(28,719,784)
Proceeds from the sale of fixed-income and equity securities	17,301,363	21,589,285
Investment income received	399,408	409,733
	<u>17,692,752</u>	<u>(6,720,766)</u>
NET CASH AND CASH EQUIVALENTS PROVIDED (USED) BY INVESTING ACTIVITIES		
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,719,741	(12,611,321)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>17,246,803</u>	<u>29,858,124</u>
TOTAL CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 18,966,544</u>	<u>\$ 17,246,803</u>
RECONCILIATION OF NET OPERATING LOSS TO NET CASH AND CASH EQUIVALENTS USED BY OPERATING ACTIVITIES		
Net operating loss	\$ (50,119,566)	\$ (28,492,873)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Bad debt (recoveries) expense	(14,838)	35,000
Depreciation	2,091	2,087
Decrease (increase) in operating assets:		
Premiums receivable	42,040	(72,073)
Rebates receivable	(476,709)	(719,975)
Experience rated refund receivable	189,500	(189,500)
Other assets	525,447	(321,970)
Increase (decrease) in operating liabilities:		
Unpaid claims and claims adjustment expenses	5,708,074	7,561,047
Accounts payable	(108,200)	164,489
Advance premiums	(107,043)	(133,145)
Unapplied premiums	2,180	(779)
Other liabilities	154,987	(9,446)
	<u>154,987</u>	<u>(9,446)</u>
NET CASH AND CASH EQUIVALENTS USED BY OPERATING ACTIVITIES	<u>\$ (44,202,037)</u>	<u>\$ (22,177,138)</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS:		
Cash and cash equivalents	\$ 18,061,878	\$ 16,182,552
Restricted cash and cash equivalents	904,666	1,064,251
	<u>\$ 18,966,544</u>	<u>\$ 17,246,803</u>

**THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2013 and 2012**

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 Position, 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.

The federal pool's last operating period ended June 30, 2013. No claim for any covered service provided after the operating period is an allowable cost under the PCIP contract. There will be a contract close-out period of 18 months beginning on July 1, 2013.

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 (GAAP), 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
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2013 and 2012

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 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* and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, an amendment of GASB Statements No. 14 and 34. 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 Position
- Statements of Revenues, Expenses and Changes in Net Position
- Statements of Cash Flows
- Notes to Financial Statements

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT OF UNIT OF THE STATE OF NORTH CAROLINA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2013 and 2012

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, liabilities, and capital of the Pool.

The Statements of Revenues, Expenses, and Changes in Net Position for special-purpose governments engaged in business-type activities requires an operating/nonoperating format to be used. The Statements of Cash Flows are presented under the direct method, which depicts cash flows from operating activities and a reconciliation of operating cash flows to operating income.

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 position may be available to cover an expense incurred. In those few cases, as long as the expense meets all the requirements of the restricted net position, 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 Position

The Pool's net position is classified as invested in capital assets, which represent the Pool's total investment in capital assets net of accumulated depreciation, restricted assets, which include any net position associated with the operation of the federal pool, and unrestricted net position, 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.

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, interest and dividend income is recognized as investment income in the accompanying Statements of Revenues, Expenses, and Changes in Net Position. Realized capital losses are the difference between the cost basis of investments sold and the proceeds received. Realized capital losses are included in the accompanying Statements of Revenues, Expenses, and Changes in Net Position.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments (Continued)

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 Position, 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 Position.

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 recorded against unrestricted and restricted premiums receivable at June 30, 2013 and 2012 was approximately \$25,000 and \$40,000, 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. Unrestricted and restricted premiums receivable net of allowance for doubtful accounts at June 30, 2013 and 2012 were \$14,924 and \$42,126, 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 Position.

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 Position.

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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, 2013 and 2012 was \$2,091 and \$2,087, 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 useful 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 Position.

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 ending December 31, 2013. The unobligated unearned grant revenue is the difference between the amount obligated for current policyholders and the maximum funds available through December 31, 2013, per the grant agreement.

Unearned State Aid

The Pool receives funding from the North Carolina Department of Health and Human Services (HHS) to prepay deductibles and premium subsidies for certain members in the Federal Pool. Amounts received in aid in excess of the amounts earned pursuant to the contract between the Pool and HHS is classified as unearned state aid in the accompanying Statements of Net Position.

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NOTES TO FINANCIAL STATEMENTS
June 30, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Position.

The Pool classifies its revenues as operating or nonoperating in the accompanying Statements of Revenues, Expenses and Changes in Net Position. 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, 2013 and 2012, non-operating revenue sources accounted for 31% and 27% 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 insured's, 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, 2013 and 2012.

Recent Accounting Pronouncements

During 2013, the Pool adopted GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the FASB Statements and Interpretations, Accounting Principles Board Opinions, and the Accounting Research Bulletins of the AICPA Committee on Accounting Procedure, issued on or before November 30, 1989, which do not conflict or contradict GASB pronouncements. GASB Statement No. 62 is effective for financial statement periods beginning after December 15, 2011. The adoption of GASB Statement No. 62 did not have a material impact on the Pool's financial statements.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

During 2013, the Pool adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). GASB 63 established a new statement of net position format that reports separately all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). GASB 63 requires deferred outflows of resources and deferred inflows of resources to be reported separately from assets and liabilities. The primary financial reporting impact resulting from the implementation of GASB 63 in the Pool's financial statements was the renaming of "Net Assets" to "Net Position" and presentation of Statements of Net Position.

Subsequent Events

The Pool evaluated the recognition and disclosure of subsequent events for its financial statements through October 15, 2013, the date the financial statements were available to be issued. Note 11 provides details of subsequent events that have been identified to merit disclosure or may have a material effect on the financial condition of the Pool.

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, 2013 and 2012, the Pool had the following investments and maturities:

	2013		2012	
	Estimated Fair Value	Maturity Less than 1 Year	Maturity Over 1 Year	Estimated Fair Value
<u>Fixed-Income Securities</u>				
Certificates of deposit	\$ 1,999,625	\$ 1,999,625	\$ -	\$ 7,841,625
Government agency bonds	-	-	-	4,061,340
Corporate bonds	456,551	456,551	-	6,364,786
Municipal bonds (VRDN)	<u>720,000</u>	<u>-</u>	<u>720,000</u>	<u>1,112,065</u>
	<u>\$ 3,176,176</u>	<u>\$ 2,456,176</u>	<u>\$ 720,000</u>	<u>\$ 19,379,816</u>

The Pool is invested in mutual funds with an estimated fair value of \$0 and \$1,267,074 as of June 30, 2013 and 2012, respectively. These amounts are classified as equity securities in the accompanying Statements of Net Position.

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NOTE 2 - INVESTMENTS (Continued)

At June 30, 2013, within fixed-income securities the Pool had certificates of deposit with a bank and book balance of \$1,999,625 in various banking institutions, which were fully covered by FDIC insurance.

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 (LOC) 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 VRDNs 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 LOC-issuing bank backing the liquidity provision in the VRDNs must be rated P-1 or A-1. All VRDNs held by the Pool are backed by LOCs issued by Wells Fargo. Wells Fargo has short-term issuer ratings of F1+, P-1, and A-1 from Fitch, Moody's, and Standard and Poors, respectively.

The ratings of corporate and municipal bonds as of June 30, 2013 are as follows:

<u>Type of Bonds</u>	<u>S&P</u>	<u>Moody</u>	<u>Market Value</u>
Corporate	A-	A2	\$ 251,643
	A-	A3	<u>204,908</u>
Total corporate			456,551
Municipal (VRDN)	AA-	NR	<u>720,000</u>
Total			<u>\$ 1,176,551</u>

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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, 2013 as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash deposits	\$ 4,968,820	\$ 6,302,286
Money market fund	2,129,548	2,129,548
Money market account at bank	168,176	168,176
Money market repurchase agreement sweep	<u>11,700,000</u>	<u>11,700,000</u>
	<u>\$ 18,966,544</u>	<u>\$ 20,300,010</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. At June 30, 2013, the Pool's cash deposits bank balance in excess of the insured FDIC limit of \$250,000 were uncollateralized. The Pool mitigates its exposure to losses from these cash deposits by monitoring the financial stability of the financial institutions involved.

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	\$ 13,137	\$ -	\$ -	\$ 13,137
Accumulated depreciation	<u>(8,560)</u>	<u>(2,091)</u>	<u>-</u>	<u>(10,651)</u>
Net	<u>\$ 4,577</u>	<u>\$ (2,091)</u>	<u>\$ -</u>	<u>\$ 2,486</u>

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June 30, 2013 and 2012

NOTE 5 - LIABILITY FOR UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES

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

	<u>2013</u>	<u>2012</u>
Balance at July 1	\$ <u>15,289,134</u>	\$ <u>7,728,087</u>
Incurred related to:		
Current year	119,623,755	77,797,309
Prior years	<u>(3,409,631)</u>	<u>(1,616,160)</u>
Total incurred	<u>116,214,124</u>	<u>76,181,149</u>
Paid related to:		
Current year	101,369,058	63,787,473
Prior years	<u>9,136,992</u>	<u>4,832,629</u>
Total paid	<u>110,506,050</u>	<u>68,620,102</u>
Balance at June 30	<u>\$ 20,997,208</u>	<u>\$ 15,289,134</u>

The total incurred claim and claim adjustment expenses above excludes pharmaceutical rebates earned of \$3,709,885 and \$2,439,563 for the years ended June 30, 2013 and 2012, respectively. As of June 30, 2013 and 2012, pharmaceutical rebates received of \$3,233,176 and \$1,176,534, respectively, is excluded from the claim and claims adjustment expenses paid in the table above.

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 \$3,409,631 in fiscal 2013 and \$1,616,160 in fiscal 2012.

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 2013 or 2012. 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.

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June 30, 2013 and 2012

NOTE 6 - REINSURANCE ACTIVITY (Continued)

Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy. At June 30, 2013 and 2012, 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, \$0 and \$189,500 was accrued as a receivable from the reinsurer as of June 30, 2013 and 2012, 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 2013 calendar year stipulates that the Pool retain a maximum of \$450,000 of coverage per covered person, subject to a 90% coinsurance. The liability to the reinsurer is also limited to \$495,000 per covered person, subject to a lifetime limit of \$1,000,000.

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

	<u>2013</u>		<u>2012</u>	
	<u>Written</u>	<u>Earned</u>	<u>Written</u>	<u>Earned</u>
Direct	\$ 72,332,190	\$ 72,332,190	\$ 54,244,347	\$ 54,244,347
Ceded	<u>(292,076)</u>	<u>(292,076)</u>	<u>(479,243)</u>	<u>(479,243)</u>
Net	<u>\$ 72,040,114</u>	<u>\$ 72,040,114</u>	<u>\$ 53,765,104</u>	<u>\$ 53,765,104</u>

There were no recoveries related to claims incurred under the reinsurance contracts for 2013 and 2012.

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, 2013 was \$19,153. As of June 30, 2013, future minimum rental payments for the year ending June 30, 2014 were \$9,810.

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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, 2013 and 2012, the Pool's contributions to the plan were \$18,687 and \$17,323, based on eligible salaries of \$451,665 and \$290,082, 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 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. 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, 2013 and 2012, this amounted to a reduction of earned premiums totaling \$1,144,139 and \$684,268, respectively.

The Federal Pool is reimbursed by HHS for allowable and allocable administrative costs and claim costs in the development and operation of the Pool. At June 30, 2013, the effective termination date of the Federal Pool, the Federal Pool had accrued receivable of \$7,462,941 from HHS for allowable and allocable administrative costs, including claim costs incurred. The accrued receivable is expected to be collected after payment of the allowable incurred June 30, 2013 expenses.

In 2013, through legislation of the North Carolina General Assembly, the Federal Pool received nonoperating revenue for coverage of participants in AIDS Drug Assistance Program (ADAP) who are uninsured and meet all Federal Pool eligibility requirements. In return for coverage and services, the Federal Pool received state aid to prepay ADAP members' deductible and subsidize premiums. The Federal Pool received \$2,730,600 in aid and had earned \$2,586,940 of the aid, of which \$143,660 was unearned as of June 30, 2013. On June 30, 2013, the contract was terminated and any unearned aid must be returned within 180 days of termination of the agreement.

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NOTES TO FINANCIAL STATEMENTS
June 30, 2013 and 2012**

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.

NOTE 11 - SUBSEQUENT EVENT

On July 26, 2013 the North Carolina General Assembly ratified House Bill 92 (HB 92). Section 28.5(a) of HB 92 amends Part 6 of Article 50 of Chapter 58 of the General Statutes by adding Section 58-50-260, *Dissolution of Pool*.

Under this law, the Pool's insurance operations shall sunset on January 1, 2014. All invoices for medical, pharmacy, and any other services provided must be submitted no later than 90 days after January 1, 2014. All appeals or grievances must also be submitted no later than 90 days after January 1, 2014.

On or before September 1, 2013, the Pool was required to submit a plan for the dissolution of the Pool to the North Carolina Commissioner of Insurance. This plan addressed the winding down of the Pool's operations, including the management of funding held in reserve to be used in connection with actions by or against the Pool that are timely filed in accordance with G.S. 58-56-260(f). This statute states, "Notwithstanding any longer statute of limitations provided under law for an action, all actions by or against the Pool must be filed on or before one year following the sunset of insurance operations of the Pool under subsection (a) of this section. After final dissolution of the Pool, the Pool's liability for insurance benefits, provider or vendor invoices, and all other matters shall be limited to the reserve amount established under subdivision (9) of subsection (d) of this section, less the costs of resolving the claims by or against the Pool."

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NOTE 11 - SUBSEQUENT EVENT (Continued)

After dissolution of the Pool, any funds remaining in the reserve established under Subdivision (9) of Subsection (d) will be paid to the North Carolina General Fund. These funds are to be held in reserve to be used in connections with actions filed by or against the Pool, which should be on or before January 1, 2015. After the resolution of timely filed actions against the Pool, any reserve funds remaining will be paid to the North Carolina General Fund.

Section 28.5(b) of HB 92 rewrites North Carolina General Statutes to provide funding for the Pool from the Teachers' and State Employees' Comprehensive Major Medical Plan (the Plan). The Plan will pay an annual surcharge of \$1.50 per member per year based on the enrollment of active employee Plan members and their dependents covered under the Plan. The final surcharge will be paid to the Pool for fiscal year 2013 to 2014 in quarterly installments 60 days after the close of each quarter and due December 1, 2013, March 1, 2014, June 1, 2014, and September 1, 2014.

REQUIRED SUPPLEMENTARY INFORMATION

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
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FIVE-YEAR CLAIMS DEVELOPMENT INFORMATION (UNAUDITED)
June 30, 2013, 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 five 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>	<u>2013</u>
(1) Premiums, investment, and other revenues:					
Premiums earned, net State and federal aid revenue	\$ 2,607,553	\$ 15,323,244	\$ 33,102,921	\$ 53,765,104	\$ 72,040,114
Investment income	22,871,880	10,453,118	14,505,740	19,271,388	31,883,558
Net earned	<u>212,195</u>	<u>342,675</u>	<u>466,926</u>	<u>187,894</u>	<u>119,719</u>
	<u>25,691,628</u>	<u>26,119,037</u>	<u>48,075,587</u>	<u>73,224,386</u>	<u>104,043,391</u>
(2) Unallocated expenses	\$ 1,220,826	\$ 2,208,772	\$ 4,939,988	\$ 9,341,391	\$ 9,902,441
(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	\$ 119,623,755
Ceded	<u>-</u>	<u>-</u>	<u>(136,232)</u>	<u>-</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>	<u>119,623,755</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
FIVE-YEAR CLAIMS DEVELOPMENT INFORMATION (UNAUDITED)
June 30, 2013, 2012, 2011, 2010 and 2009

	2009	2010	2011	2012	2013
(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	\$ 101,369,058
One year later	2,562,795	13,733,970	38,148,235	72,918,499	-
Two years later	2,570,056	13,761,642	38,146,632	-	-
Three years later	2,570,172	13,769,212	-	-	-
Four 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	\$ 119,623,755
One year later	2,667,105	14,208,798	39,517,533	75,751,009	-
Two years later	2,662,366	13,761,642	38,146,632	-	-
Three years later	2,570,172	13,769,212	-	-	-
Four 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)	\$ (1,704,699)	\$ (2,447,711)	\$ (2,046,300)	\$ -

Note: Only five years of information is presented for the Pool, which represents inception through June 30, 2013. 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 position as determined on a contract-year basis will differ from that included in the Pool's accompanying basic financial statements.

OTHER FINANCIAL INFORMATION

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
SCHEDULE OF OTHER EXPENSES
June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CONTRACTUAL EXPENSES		
Accounting	\$ 69,273	\$ 87,544
Actuarial services	97,866	87,565
Administrative services	7,831,537	5,475,145
Audit services	42,936	41,616
Communication/Outreach	70,116	990,676
Legal	59,824	41,116
PBM procurement	169	788
Producer compensation	817,627	1,229,200
	<u>8,989,348</u>	<u>7,953,650</u>
PERSONNEL EXPENSES		
Insurance	27,501	24,143
Payroll taxes	22,194	21,378
Retirement plan contribution	18,687	17,323
Salaries	451,665	290,082
Travel	5,154	12,613
Other personnel expenses	11,380	10,342
	<u>536,581</u>	<u>375,881</u>
GENERAL EXPENSES		
Bad debts (recoveries)	(14,838)	35,000
Insurance	20,191	18,193
Postage and delivery	564	2,260
Rent	19,153	18,584
Telephone	6,369	8,168
Other general expenses	98,073	104,655
	<u>129,512</u>	<u>186,860</u>
	<u>129,512</u>	<u>186,860</u>
	<u>\$ 9,655,441</u>	<u>\$ 8,516,391</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
STATEMENTS OF NET POSITION BY PROGRAM
June 30, 2013

	<u>State</u>	<u>Federal</u>	<u>Eliminations</u>	<u>Total</u>
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 18,061,878	\$ -	\$ -	\$ 18,061,878
Fixed-income securities	2,456,176	-	-	2,456,176
Accrued interest	11,240	-	-	11,240
Premiums receivable, net of allowance of \$25,000	14,924	-	-	14,924
Grants receivable	797,142	-	-	797,142
Rebates receivable	1,583,582	-	-	1,583,582
Due from federal risk pool	38,475	-	(38,475)	-
Other assets	31,461	-	-	31,461
Restricted assets:				
Cash and cash equivalents	-	904,666	-	904,666
Grants receivable	-	7,462,941	-	7,462,941
Rebates receivable	-	548,212	-	548,212
Other assets	-	13,462	-	13,462
Total current assets	<u>22,994,878</u>	<u>8,929,281</u>	<u>(38,475)</u>	<u>31,885,684</u>
Noncurrent assets:				
Fixed-income securities	720,000	-	-	720,000
Capital assets, net of accumulated depreciation of \$10,651 and \$0 in State and Federal Pool, respectively	2,486	-	-	2,486
Total noncurrent assets	<u>722,486</u>	<u>-</u>	<u>-</u>	<u>722,486</u>
TOTAL ASSETS	<u>\$ 23,717,364</u>	<u>\$ 8,929,281</u>	<u>\$ (38,475)</u>	<u>\$ 32,608,170</u>
LIABILITIES AND NET POSITION				
LIABILITIES				
Current liabilities:				
Unpaid claims and claims adjustment expenses	\$ 12,332,201	\$ 8,665,007	\$ -	\$ 20,997,208
Accounts payable	94,704	1,323	-	96,027
Unearned federal grant revenue:				
Obligated grant	740,553	-	-	740,553
Unobligated grant	56,589	-	-	56,589
Unearned state aid	-	143,660	-	143,660
Advance premiums	223,871	2,538	-	226,409
Unapplied premiums	4,446	(190)	-	4,256
Due to state risk pool	-	38,475	(38,475)	-
Other liabilities	86,997	78,468	-	165,465
Total current liabilities	<u>13,539,361</u>	<u>8,929,281</u>	<u>(38,475)</u>	<u>22,430,167</u>
NET POSITION				
Net investment in capital assets	2,486	-	-	2,486
Unrestricted	10,175,517	-	-	10,175,517
Total net position	<u>10,178,003</u>	<u>-</u>	<u>-</u>	<u>10,178,003</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 23,717,364</u>	<u>\$ 8,929,281</u>	<u>\$ (38,475)</u>	<u>\$ 32,608,170</u>

THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION BY PROGRAM
Year Ended June 30, 2013

	<u>State</u>	<u>Federal</u>	<u>Eliminations</u>	<u>Total</u>
PREMIUMS EARNED, NET	\$ 52,976,887	\$ 19,063,227	\$ -	\$ 72,040,114
TOTAL OPERATING REVENUES	<u>52,976,887</u>	<u>19,063,227</u>	<u>-</u>	<u>72,040,114</u>
OPERATING EXPENSES				
Claims expense	68,079,911	44,424,328	-	112,504,239
Contractual expenses	5,747,209	3,242,139	-	8,989,348
Personnel expenses	268,385	268,196	-	536,581
General expenses	86,290	43,222	-	129,512
TOTAL OPERATING EXPENSES	<u>74,181,795</u>	<u>47,977,885</u>	<u>-</u>	<u>122,159,680</u>
NET OPERATING LOSS	<u>(21,204,908)</u>	<u>(28,914,658)</u>	<u>-</u>	<u>(50,119,566)</u>
NONOPERATING REVENUE (LOSSES)				
State aid	712,405	2,586,939	-	3,299,344
Federal aid	2,256,495	26,327,719	-	28,584,214
Investment income	555,245	-	-	555,245
Realized capital losses	(435,526)	-	-	(435,526)
TOTAL NONOPERATING REVENUE, NET	<u>3,088,619</u>	<u>28,914,658</u>	<u>-</u>	<u>32,003,277</u>
DECREASE IN NET POSITION	(18,116,289)	-	-	(18,116,289)
NET POSITION, BEGINNING OF YEAR	<u>28,294,292</u>	<u>-</u>	<u>-</u>	<u>28,294,292</u>
NET POSITION, END OF YEAR	<u>\$ 10,178,003</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,178,003</u>



DIXON HUGHES GOODMAN LLP
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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States, 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, 2013, and have issued our report thereon dated October 15, 2013. Our report included an emphasis of matter paragraph related to the planned dissolution of the Pool.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Pool's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Pool's internal control.

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. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Pool's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the Pool's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dixon Hughes Goodman LLP

October 15, 2013

**THE NORTH CAROLINA HEALTH INSURANCE RISK POOL, INC.
d/b/a INCLUSIVE HEALTH
(A COMPONENT OF UNIT OF THE STATE OF NORTH CAROLINA)
AUDIT HOURS AND COST
June 30, 2013**

This audit required approximately 315 audit hours at a cost of \$44,700.