

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

*Years ended December 31, 2012 and 2011
with Report of Independent Auditors*

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

Years ended December 31, 2012 and 2011

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Report of Independent Auditors

The Board of Directors
VLCT Health Trust, Inc.

We have audited the accompanying financial statements of VLCT Health Trust, Inc. ("the Trust"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of contributions, expenses, and changes in net position and cash flows for the years then ended and the related notes to the financial statements.

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.

Auditor's 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the 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 the auditor's 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 financial statements referred to above present fairly, in all material respects, the respective financial position of VLCT Health Trust, Inc. as of December 31, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The accounting principles generally accepted in the United States require that the Management's Discussion and Analysis on pages 3 - 10 and the accompanying financial information listed on pages 22 - 24 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 Information

Our audits were conducted for the purpose of forming an opinion on the Trust's basic audited financial statements. The other information on pages 25 - 26 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The other information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

A handwritten signature in cursive script that reads "Johnson Lambert LLP". The signature is written in black ink and is positioned to the right of the main text block.

Burlington, Vermont
April 25, 2013

Vermont firm registration: 092-0000267

VLCT Health Trust, Inc.

Management's Discussion and Analysis

Years ended December 31, 2012 and 2011

The management of VLCT Health Trust, Inc. (the "Trust") presents the following overview and analysis of its financial operations for the fiscal year ended December 31, 2012, to be reviewed and considered in conjunction with the more detailed statements, schedules, exhibits and notes in the ensuing pages of this report.

Highlights

- Assets exceeded liabilities by \$2,272,314 as of December 31, 2012. This compares with a net position of \$2,146,869 and \$2,667,711 as of December 31, 2011 and 2010, respectively. Net position was unrestricted for 2012, 2011 and 2010.
- Total assets decreased from 2011 by \$500,332 or 18%, offset by a larger decrease in liabilities of \$625,777 or 97%. Both decreases were the result of the change in operations to a carrier choice model, eliminating health insurance premiums on the revenue side and claims costs on the expense side.
- An operating loss of \$7,832 was offset by investment earnings of \$133,277, resulting in a change in net position of \$125,445. The operating loss was due to lower commissions than expected at the time the budget was developed. Investment income was primarily from realized gains from equities that were liquidated to reduce risk as the Trust determines its future direction with the federal and state health care reform changes.
- Net position increased by \$125,445 as of December 31, 2012 compared with an decrease of \$520,842 in 2011 and an increase of \$28,918 in 2010. All three years experienced operating losses with the smallest loss in 2012. Operating losses for 2012, 2011 and 2010 were \$7,832, \$624,523 and \$131,728 respectively. In both 2012 and 2010, these losses were offset by higher investment earnings, resulting in positive changes in net position. Investment earnings for 2011 however were not sufficient to fully cover the operating loss.

Overview of the Trust's Financial Statements

The Trust's fiscal year is January 1 through December 31.

The Trust operations are divided into three cost centers in order to better manage the budgets for administrative costs, although they are combined under operating expenses in the financial statements that follow this discussion and analysis. These cost centers include administration, member relations and wellness (health promotion).

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

The first cost center is to account for all administrative costs of the Trust operations. This includes overhead paid to Vermont League of Cities and Towns and other general administrative costs relating to the Trust.

The second cost center is member relations. This includes both indirect and direct costs attributable to marketing its products and providing customer service to members of the Trust. These products include health, dental, life, vision, disability and long-term care insurances, as well as administration of Section 125 cafeteria plans and COBRA administration.

The third cost center is to account for wellness expenses for the health promotion program. These costs are shared by both the Trust and the Property and Casualty Intermunicipal Fund ("PACIF") on a 50%/50% basis with 100% of the wellness expenses budgeted in the Trust and the 50% due from PACIF appearing as offsetting revenue.

The annual financial report consists of four parts:

- Management's Discussion and Analysis
- Financial Statements and Disclosures
- Required Supplementary Information
- Supplementary Information

Management's discussion and analysis provides a narrative overview of the statements and comments on significant developments during the reporting period. The intention is to present a financial summary of operations for the past fiscal year and discuss the outlook for the ensuing year.

Required statements include:

- Statements of Net Position
- Statements of Revenues, Expenses, and Changes in Net Position
- Statements of Cash Flows
- Notes to the Financial Statements

These statements present the Trust's status at December 31, 2012 and 2011 and financial development during 2012 for all cost centers combined.

The statements of net position present the economic position of the Trust, showing the assets owned by the Trust and how those assets are financed: by debt or short-term obligations, and by net position (the Trust's equity). The Trust has no debt.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

The statements of revenues, expenses and changes in net position show the operating activities for the year. As required by the Government Accounting Standards Board, investment income is considered a non-operating revenue. The result of operations is the change in net position. This figure added to last fiscal year's net position is the new net position total shown in both the statements of net position and statement of revenues, expenses and changes in net position.

The statements of cash flows outlines the cash flow resulting from operations, investment, and financing activities of the Trust. This statement shows how the financial resources were used during the course of the year.

Notes to the financial statements provide explanations of the accounting principles followed and of key items in the financial statements. They include tables with detailed analysis of certain accounts.

The required supplementary schedules include the ten year claims development and a two year comparative reconciliation of claims liabilities. The supplementary schedule presents a Schedule of revenue and expenses comparing budget to actual for the year ending December 31, 2012. The supplementary schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements.

Results and Analysis

The following table summarizes the statement of net position:

	<u>December 31,</u> 2012	<u>December 31,</u> 2011	<u>Percentage</u> <u>Change</u>	<u>December 31,</u> 2010	<u>Percentage</u> <u>Change</u>
Cash and Investments	\$ 2,101,106	\$ 2,291,460	(8.3)%	\$ 3,265,620	(29.8)%
Other assets	<u>191,459</u>	<u>501,437</u>	(61.8)%	<u>917,434</u>	(45.3)%
Total assets	2,292,565	2,792,897	(17.9)%	4,183,054	(33.2)%
Claims Payable	4,311	243,784	(98.2)%	327,102	100.0 %
Other Liabilities	<u>15,940</u>	<u>402,244</u>	(96.0)%	<u>1,188,241</u>	(66.1)%
Total liabilities	20,251	646,028	(96.9)%	1,515,343	(57.4)%
Net position					
Unrestricted	<u>2,272,314</u>	<u>2,146,869</u>	5.8 %	<u>2,667,711</u>	(19.5)%
Total net position	<u>\$ 2,272,314</u>	<u>\$ 2,146,869</u>	5.8 %	<u>\$ 2,667,711</u>	(19.5)%

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

As of December 31, 2012, total assets decreased by 18% from \$2,792,897 to \$2,292,565. This compares with a decrease of 33% in 2011 and 6% in 2010. The overall decrease in total assets from 2010 to 2012 reflects the changing operations. The large operating loss in 2011 from higher claim costs reduced cash and investments accordingly. Moving to the carrier choice model in 2012 eliminated the claim-related assets and liabilities, aside from a small amount offset by the working fund balance that will be released in 2013, significantly reducing the scope of the financial activity and budget.

Cash and investments decreased from 2011 to 2012 by 8%, or \$190,354. Cash and investments decreased from 2010 to 2011 by 30%, and increased from 2009 to 2010 by 16%. At the end of 2011 and into 2012, equity investments were liquidated in preparation for the transition to the carrier choice model. Cash flow from commissions took a full quarter to reach the level necessary to sustain operations.

As of December 31, 2012, total liabilities decreased by 97% or \$625,777 with no claim-related liabilities recorded at year end. At the end of 2011, total liabilities decreased by 57% and in 2010 by 18.7%. The decrease in 2011 was attributable to the reduction in unearned income; with the change to the carrier choice model, the Trust would not be collecting health insurance premiums in 2012, therefore there were no payments made by members for a January 1st billing. The 2010 decrease was also the result of a drop in unearned income resulting from the loss of members between 2009 and 2010.

Net position, as discussed in the Highlights section above, increased by \$125,445 as of December 31, 2012 compared with a decrease of \$520,842 in 2011 and an increase of \$28,918 in 2010. Investment earnings off-set operating deficits in 2010 and 2012, and reduced the largest operating loss of that three year period in 2011.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

The following table summarizes the statement of revenues, expenses and changes in net position. It shows net loss from operations in the first section of the statement, then applies investment income to the result to come up with the total change in net position.

	<u>2012</u>	<u>2011</u>	Percentage Change	<u>2010</u>	Percentage Change
Operating revenues:					
Commission Income	\$ 728,916	\$ -	100.0 %	\$ -	- %
Health insurance premiums	-	21,837,556	(100.0)	26,578,236	(17.8)
Administrative fees	77,406	1,056,347	(92.7)%	1,095,461	(3.6)%
Other revenues	<u>141,731</u>	<u>218,772</u>	(35.2)%	<u>205,929</u>	6.2 %
Total operating revenues	948,053	23,112,675	95.9 %	27,879,626	(17.1)%
Operating expenses:					
Claims paid	-	20,098,971	(100.0)%	23,662,504	(15.1)%
Health insurance administration & insurance premiums paid	-	2,382,902	(100.0)%	3,065,602	(22.3)%
Operating expenses	<u>955,885</u>	<u>1,255,325</u>	(23.9)%	<u>1,283,248</u>	(2.2)%
Total operating expenses	<u>955,885</u>	<u>23,737,198</u>	(96.0)%	<u>28,011,354</u>	(15.3)%
Operating loss	<u>(7,832)</u>	<u>(624,523)</u>	(98.7)%	<u>(131,728)</u>	374.1 %
Non-operating revenues:					
Investment income (net of fees)	<u>133,277</u>	<u>103,681</u>	28.5 %	<u>160,646</u>	(35.5)%
Change in net position	125,445	(520,842)	(124.1)%	28,918	(1,901.1)%
Net position, beginning of year	<u>2,146,869</u>	<u>2,667,711</u>	(19.5)%	<u>2,638,793</u>	1.1 %
Net position, end of year	<u>\$ 2,272,314</u>	<u>\$ 2,146,869</u>	5.8 %	<u>\$ 2,667,711</u>	(19.5)%

Trust operations for 2012 resulted in a net operating loss of \$7,832. The net operating loss in 2011 and 2010 was \$624,523 and \$131,728, respectively. Net investment income of \$133,277 (\$85,844 of which was the change in fair value, both realized and unrealized) offset the operating loss and resulted in a change in net position of \$125,445 as of December 31, 2012. Of the total investment earnings for 2012, \$106,431 was in realized gains from equities that were liquidated to reduce risk as the Trust makes decisions about its future direction. The health care reform changes at both the federal and state levels will impact the Trust in a way that makes the additional risk imprudent. Investment income for 2010 and 2011 was \$160,646 and \$103,681 respectively and market gains of \$106,535 and \$42,494 respectively.

Total operating revenues in 2012 were \$948,053. This is about \$22.2 million lower than in 2011 due to the elimination of health insurance premiums from the transition to a carrier choice model. Commissions and administrative fees make up about 85% of the total revenue recognized for 2012.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Operating expenses associated with the new carrier choice model at year-end were \$955,885. These were about \$22.8 million lower than in 2011 with the elimination of claim-related costs, again due to the change to a carrier choice model. These expenses include the costs of administration, marketing and wellness initiatives. Operating costs were reduced by almost 24% from 2011, with lower administrative and wellness costs (down about 18% and 46% respectively) associated with the new business model. Member relation costs increased about 11% due to the work necessary to transition current members to the new carrier choice model and educate and enroll new members into the program. These efforts resulted in the Trust gaining a net of seven new members, from 193 in 2011 to 200 in 2012.

The following table presents a budget to actual comparison in summarized form for the year ended December 31, 2012. The purpose of this summary is to show the variance between what was budgeted and what was actually received or spent. Both revenues and expenses combine the results from operations with the results from investments.

	<u>Budget</u>	<u>Actual</u>	<u>% Variance</u>
Operating revenues:			
Commissions	\$ 859,270	\$ 728,916	(15.2)%
Administrative fees	29,000	77,406	166.9 %
Other revenues	<u>160,875</u>	<u>141,731</u>	<u>(11.9)%</u>
Total operating revenues	1,049,145	948,053	(9.6)%
Operating expenses:			
Operating expenses - all cost centers	<u>1,041,150</u>	<u>955,885</u>	<u>(8.2)%</u>
Total operating expenses	<u>1,041,150</u>	<u>955,885</u>	<u>(8.2)%</u>
Operating deficiency of revenues over expenditures	7,995	(7,832)	(198.0)%
Non-operating - Investment income	<u>-</u>	<u>133,277</u>	<u>100.0 %</u>
Excess of expenditures over revenues	<u>\$ 7,995</u>	<u>\$ 125,445</u>	<u>1,469.0 %</u>

Total revenue for 2012 was \$101,092 or 10% below budget, primarily due to lower than expected commissions. Although the Trust experienced a net gain of seven members, it also lost a couple of larger ones, reducing overall premiums upon which the commissions are based. In addition, MVP, one of the carriers the Trust receives commissions from, changed from a percentage based commission to a per member fee, reducing the amount of commission it paid to its brokers.

Other operating expenses are 8% below budget in 2012, primarily due to a reduction in VLCT administration costs which ended the year below budget by 7.5% after the final true-up. VLCT's decision not to relocate its office resulted in savings that were allocated back to all three trusts. The total savings to the Trust was \$55,413 or 71% of the total expenses below budget.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

More significant variances to note within the individual budgets under operating expenses:

- Administrative contracts exceeded budget by about \$8,000 or 20% from under-budgeting for the Choice COBRA administrative costs.
- Vehicle expense in the Member Relations cost center was double the budget (\$12,189 versus a budget of \$6,000) primarily due to unanticipated increase in member visits from the transition to the new model, necessitating heavier member assistance efforts.
- Member training costs were significantly lower than budgeted in the Wellness cost center due a shift in the way the bulk training supply orders that are pre-ordered for the ensuing year are booked. In prior years these were ordered in advance and booked as current year expenses, overstating expenses for that cost center. In 2012, this was corrected and expenses associated with 2013 programs were booked as prepaid expenses on the balance sheet. This resulted in costs ending the year below budget by about \$14,400 or 36%.

Outlook / Economic Factors

The Vermont health insurance delivery system continues its evolution towards a state operated single payer/ universal health system slated to begin in 2017. In the meantime, the state will be opening Vermont Health Connect (its federally mandate health benefit exchange) for business in October 2013 for coverage effective January 1, 2014. These upcoming changes will have profound impact on the Health Trust.

Effective January 1, 2012, the Health Trust moved to a "Carrier Choice" model to provide health coverage for its members. With this approach, the Health Trust offers market pricing on health insurance coupled with its unparalleled selection of complementary services and products.

To facilitate Carrier Choice, the Trust has partnered with Hickok Boardman Group Benefits (HBGB), which brings a depth of knowledge, experience, and tools to navigate the Vermont insurance marketplace. The Health Trust continues to offer group rates for dental, vision, life, disability, long term care insurances as well as assistance with cafeteria plans. The Health Trust continues to provide a comprehensive array of health promotion and wellness service to its members.

Our renewal efforts for 2012 and 2013 were successful and the Trust was able to add new municipal members and increase enrollment. This positive result ended a string of years of declining membership and subscribers.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

The upcoming move to Vermont Health Connect (VHC) will require another significant change in the Health Trust's business model. Vermont Health Connect, operated by the State of Vermont, will be the exclusive health insurance market for small businesses (50 or fewer employees) and individuals. The vast majority of Vermont municipalities have 50 or less employees and will therefore be purchasing their health insurance through VHC.

In VHC, insurance agent commissions will no longer be paid by the health insurance company but rather negotiated between the employer and the insurance agent directly. Because small businesses can obtain similar assistance from state funded "Navigator" at no cost, it is expected that insurance agent compensation in this market will be substantially less than the current level.

While the large group market will, for now, continue as it has in the past, the change in the small group market requires that the Health Trust reconsider its role in the health insurance marketplace and seek new sources of revenue to fund operations. The Health Trust Board is in the process of a proactive, in depth review of Health Trust programs and services, as well as member needs, to redefine the role and financing of the Health Trust going forward. The Board is committed to helping its members find their way through the transition of Vermont's health delivery and funding system. The Board realizes that, over the next few years, some of the Trust's accumulated Net Position may be used to help offset costs through this transition. It is management's strong belief that the Trust's Net Position and funding sources will be adequate to carry the Health Trust through the challenging and exciting process of health system reform.

Requests for Information

For additional information, please contact the Chief Financial Officer at the Vermont League of Cities and Towns, 89 Main Street, Suite 4, Montpelier, Vermont, 05602-2948, or call 802-229-9111.

VLCT Health Trust, Inc.

Statements of Net Position

	As of December 31,	
	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 976,058	\$ 495,476
Mutual funds, at fair value	-	424,793
Fixed-maturity securities, at fair value	1,125,048	1,371,191
Working fund deposit	4,311	163,449
Accrued investment income	10,234	14,884
Accounts receivable	-	40,013
Amounts due from related entities	143,028	97,159
Health insurance administration receivable	-	169,996
Prepaid expenses	<u>33,886</u>	<u>15,936</u>
 Total Assets	 <u>\$ 2,292,565</u>	 <u>\$ 2,792,897</u>
 Liabilities and Net Position		
Liabilities		
Claims payable	\$ 4,311	\$ 243,784
Accounts payable and accrued expenses	<u>15,940</u>	<u>402,244</u>
Total liabilities	20,251	646,028
 Net Position		
Unrestricted	<u>2,272,314</u>	<u>2,146,869</u>
 Total Liabilities and Net Position	 <u>\$ 2,292,565</u>	 <u>\$ 2,792,897</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Statements of Revenues, Expenses, and Changes in Net Position

	Years ended December 31,	
	<u>2012</u>	<u>2011</u>
Operating Revenues		
Health insurance premiums	\$ -	\$ 21,837,556
Administration Fee - Medical	-	959,723
Administration Fee - Dental	36,298	30,380
Administration fees - Disability/Life	41,108	66,244
PACIF share of wellness contract	138,601	155,099
Commission income	728,916	-
Other income	<u>3,130</u>	<u>63,673</u>
Total operating revenues	948,053	23,112,675
Operating Expenses		
Claims paid	-	20,098,971
Health insurance administration	-	2,382,902
Leader program	31,422	218,462
General and administrative expenses	<u>924,463</u>	<u>1,036,863</u>
Total operating expenses	955,885	23,737,198
Operating loss	(7,832)	(624,523)
Non-Operating Revenues (Expenses)		
Investment income	54,154	71,063
Investment income - net realized gain and change in fair value	85,844	42,494
Investment management fees	(3,279)	(3,706)
Investment consulting fees	(1,713)	(2,083)
Investment banking fees	<u>(1,729)</u>	<u>(4,087)</u>
Net non-operating revenue	<u>133,277</u>	<u>103,681</u>
Change in Net Position	125,445	(520,842)
Net Position, Beginning of Year	<u>2,146,869</u>	<u>2,667,711</u>
Net Position, End of Year	<u>\$ 2,272,314</u>	<u>\$ 2,146,869</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Statements of Cash Flows

	Years ended December 31,	
	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities		
Receipts for insurance premiums	\$ -	\$ 20,954,216
Receipts for administrative fees and commissions	806,322	1,056,347
Other receipts	117,925	196,457
Payments for claims	(69,477)	(19,642,005)
Payments for healthcare administration	-	(2,384,476)
Payments from the Working Fund Deposit	159,138	(101,772)
Payments for administration	<u>(1,342,189)</u>	<u>(1,156,408)</u>
Net cash used in operating activities	(328,281)	(1,077,641)
Cash Flows from Investing Activities		
Receipts of interest income	58,804	70,863
Investment fees paid	(6,721)	(9,876)
Purchases of investments	(883,643)	(1,253,647)
Proceeds of investments	<u>1,640,423</u>	<u>1,341,284</u>
Net cash provided by investing activities	808,863	148,624
Net change in cash and cash equivalents	480,582	(929,017)
Cash and Cash Equivalents, Beginning of Year	<u>495,476</u>	<u>1,424,493</u>
Cash and Cash Equivalents, End of Year	<u>\$ 976,058</u>	<u>\$ 495,476</u>
Reconciliation of Operating Income to Net Cash used in Operating Activities		
Operating Loss	\$ (7,832)	\$ (624,523)
Changes in assets and liabilities:		
Working fund deposit	159,138	(101,772)
Accounts receivable	40,013	(29,985)
Amounts due from related entities	(45,869)	9,895
Health insurance administration receivable	169,996	540,284
Prepaid expenses	(17,950)	(2,225)
Unearned income	-	(883,340)
Claims payable	(239,473)	(83,318)
Accounts payable and accrued expenses	(386,304)	98,917
Health insurance administration payable	<u>-</u>	<u>(1,574)</u>
Net cash used in operating activities	<u>\$ (328,281)</u>	<u>\$ (1,077,641)</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Notes to the Financial Statements

Years ended December 31, 2012 and 2011

Note A - Organization and Nature of Operations

Organization

VLCT Health Trust, Inc. (the Trust) was established in 1982 (1) to provide directly and indirectly members of the Vermont League of Cities and Towns (VLCT) with various forms of health insurance, health maintenance cost containment procedures and programs, and health-related educational programs, (2) to negotiate and procure on behalf of members of VLCT and their employees various forms of medical and dental care insurance, (3) to act as an advocate before governmental regulatory agencies with respect to medical care and health maintenance facilities, programs and insurance available to Vermont municipal employees, and (4) to develop, promote and implement health maintenance programs for the benefit of Vermont municipalities and their employees.

Effective January 1, 2012, the Health Trust moved to a "Carrier Choice" model to provide health coverage for its members. With this approach, the Health Trust offers market pricing on health insurance coupled with complementary insurance services and products. To facilitate Carrier Choice, the Trust has partnered with Hickok Boardman Group Benefits (HBGB). The Trust continues to offer group rates for dental, vision, life, disability, long-term care insurances as well as assistance with cafeteria plans.

Note B - Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the Trust have been prepared using the accrual basis of accounting in conformity with accounting principles generally accepted in the United States (GAAP) as applied to governmental entities. In accordance with Government Accounting Standards Board (GASB) Statement No. 62 *Codification of Accounting and Financial guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (Statement No. 62), the Trust follows all applicable GASB guidance. The Trust uses the economic resources measurement focus and the accrual basis of accounting and is accounted for as a proprietary enterprise fund.

Subsequent Events

The Trust has evaluated subsequent events for disclosure and recognition through April 25, 2013, the date on which these financial statements were available to be issued.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Risks and Uncertainties

The Trust's operating results and financial condition are affected by numerous factors and circumstances inherent within the insurance industry, some of which it can neither predict nor control. Among them are (1) the Trust's ability to enter into suitable future contracts or compensation agreements; (2) fluctuations in interest rates affect the value and income yield of the Trust's investment portfolio in the short-term, and often affect default and prepayment rates over time. Should any of these or similar events occur, the Trust's operating results and financial condition may be affected; (3) legislation concerning health care may continue to require the trust to review its programs and services, as well as member needs.

Investments

The Trust accounts for its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* (Statement No. 31). Statement No. 31 establishes fair value standards on accounting for all investments held by governmental external investment pools and governmental entities. All investment income, including changes in the fair value of investments, is recognized in the statement of operations. Realized gains and losses on the sale of investments are recognized on the specific identification basis to determine the costs of the investments sold. The calculation of realized gains and losses is independent of the calculation of the net change in fair value of investments. Realized gains and losses on investments that had been held for more than one year and sold in the current year were included as a change in the fair value of investments reported in the prior years and the current year. Investment purchases are recognized on the trade date. Investments are stated at fair value based on quoted market prices or prices obtained from a recognized pricing service.

Cash and Cash Equivalents

The Trust's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date acquired by the Trust.

The Trust's carrying amount of cash deposits and the bank balance at December 31, 2012 and 2011 were as follows:

	December 31, 2012		December 31, 2011	
	Book Balance	Bank Balance	Book Balance	Bank Balance
Insured/FDIC	\$ 495,476	\$ 500,000	\$ 500,000	\$ 500,000
Uninsured, Collateralized by US Gov't and Agency Securities held by the People's United Bank Trust Department with a security interest granted to the Trust	480,582	21,027	(4,524)	928,289
Total	\$ 976,058	\$ 521,027	\$ 495,476	\$ 1,428,289

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

The difference between the book balance and the bank balance is due to reconciling items such as deposits in transit and outstanding checks.

Cash and cash equivalents shown above are held at People's United Bank and Citizens Bank (New England). The Federal Deposit Insurance Corporation (FDIC) insures amounts on deposit up to the limits as prescribed by law. The Trust holds funds with financial institutions in excess of the FDIC insured amount; however, the Trust has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Working Fund Deposit

In accordance with the terms of the contract with CIGNA Healthcare (CIGNA), the Trust is required to maintain a separate account at Citibank, which is utilized solely in connection with the program administered by CIGNA. This account enables CIGNA to directly withdraw amounts due to fund claims during the year. The balance of the deposit at December 31, 2012 and 2011 was \$4,311 and \$163,449, respectively. The services provided by CIGNA are more fully discussed in Note E. Amounts due to CIGNA under the cash management program to fund outstanding claims was \$4,311 and \$243,784 at December 31, 2012 and 2011, respectively and is recorded as claims payable on the statements of net position. This contract was terminated effective December 31, 2011 and the remaining balance will be released during 2013.

Health Insurance Administrative Receivable/Payable

Under a prior funding arrangement with CIGNA, the Trust's liability for claims each year was capped at an amount equal to the predetermined claim portion of the premium established at the beginning of the plan year and multiplied by the actual number of insured lives for each month of the year. During 2011, claims totaling \$20,268,967 exceeded the Trust's funding of \$20,098,971. The remaining amount owed to the Trust from CIGNA was \$169,996 for overpayments made during the year. These amounts are recorded as health insurance administration receivable on the statement of net position.

Accounts Receivable

Accounts receivable as of December 31, 2011 consist of billed amounts not yet collected for premiums. Management anticipates no uncollectible accounts and, therefore, has not established an allowance for doubtful accounts.

Amounts Due From Related Entities

Amounts due from related entities as of December 31, 2012 and 2011 consist of wellness services billed to VLCT Property and Casualty Intermunicipal Fund, Inc. (PACIF) and a refund from VLCT for an adjustment to the allocation to the Trust for administrative expenses for 2012. Management anticipates no uncollectible accounts and, therefore, has not established an allowance for doubtful accounts.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Accounts Payable

Accounts payable as of December 31, 2012 and 2011 consist of payments due to members for participation in the Leader Program, a program designed to reward members for participation in health and wellness activities, plus amounts payable to vendors for services provided to the Trust.

Income Taxes

The Trust is incorporated as a nonprofit corporation under the Vermont Nonprofit Corporation Act. The Trust's income is tax-exempt under Internal Revenue Code Section 115, which pertains to political subdivisions. Accordingly, the accompanying financial statements do not include a provision for federal or state income taxes.

Classification of Revenues and Expenses

The Trust reports itself as a business-type activity as defined in GASB 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. Business-type activities are financed in whole or in part by fees charged to external parties. Business-type activities distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Trust's enterprise fund include fund premiums and fees received from providing services. Operating expenses include claims paid and the costs of providing services and operating all programs. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Reclassifications

Certain reclassifications have been made in the 2011 audited financial statements to conform to the 2012 presentation, which had no effect on net position or change in net position.

Note C - Investments

The Trust's investment policy, as approved by the Board of Directors (the Board), contains certain provisions and limitations intended to mitigate the Trust's exposure to various investment risks, such as credit risk (including custodial risk and concentration risk) and interest rate risk, as follows:

- *Credit risk* - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is measured by an assigned rating from a nationally recognized credit rating agency such as Standard and Poor's or Moody's Rating Services. These organizations look at a number of factors in order to evaluate the credit risk of an obligation and rate the risk. This rating allows investors to make informed buying and selling decisions. The Trust's investment policy is structured with limitations and guidelines intended to mitigate the

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note C - Investments (Continued)

components of credit risk as summarized in the following two bullet points.

- *Custodial credit risk* - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Trust will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Neither the Vermont Statutes nor the Trust's investment policy guidelines contain requirements limiting custodial credit risk other than indicating that "prudent investment policies" should be followed. An agreement with the People's United Bank, the custodial financial institution for the investment portfolio, is in place and indemnifies the Trust against losses caused by negligence or dishonesty.
- *Concentration of credit risk* - Concentration risk is the risk of loss attributable to the magnitude of an investment in a single issuer (with the exception of U.S. Obligations, which have no limit) to 5% of the total investments. There are no single investments other than U.S. Government Obligations that exceed the limit as of December 31, 2012 and 2011.
- *Interest rate risk* - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in interest rates. The Trust's investment policy limits the average effective duration to 8 years.

The following table provides a summary of the fair value of the Trust's investment in fixed-maturity securities by contractual maturity as of December 31, 2012. The expected maturities in the following table may differ from the contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalty.

	December 31, 2012				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total
U.S. Treasuries	\$ 125,438	\$ 36,062	\$ 28,784	\$ 13,521	\$ 203,805
U.S. Agencies	-	-	-	122,885	122,885
U.S. Agency MBS	-	22,182	16,922	11,670	50,774
Corporate Bonds	8,618	82,642	235,593	368,917	695,770
Municipal Bonds	-	-	10,469	34,106	44,575
Foreign Bonds	-	-	-	7,239	7,239
Total	<u>\$ 134,056</u>	<u>\$ 140,886</u>	<u>\$ 291,768</u>	<u>\$ 558,338</u>	<u>\$ 1,125,048</u>

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note C - Investments (Continued)

The table below outlines the Standard and Poor's (S&P) credit ratings of the Trust's fixed-maturity securities as of December 31, 2012:

	U.S. Treasuries	U.S. Agency MBS	U.S. Agency	Corporate Bonds	Municipal Bonds	Foreign Bonds	Total
AAA	\$ -	\$ -	\$ -	\$ 72,072	\$ -	\$ -	\$ 72,072
AA+	203,805	50,774	122,885	54,480	6,512	-	438,456
AA	-	-	-	60,647	15,816	-	76,463
AA-	-	-	-	11,993	-	-	11,993
A+	-	-	-	34,254	10,469	7,239	51,962
A	-	-	-	58,802	11,778	-	70,580
A-	-	-	-	166,261	-	-	166,261
BBB+	-	-	-	136,502	-	-	136,502
BBB	-	-	-	23,332	-	-	23,332
Not Rated	-	-	-	77,427	-	-	77,427
Total	\$ 203,805	\$ 50,774	\$ 122,885	\$ 695,770	\$ 44,575	\$ 7,239	\$1,125,048

The effective duration is used to assess interest rate risk by estimating the sensitivity of fixed income securities to interest rate changes. The effective duration estimates the percentage change in the market value of an investment (or an investment portfolio) for a one percent change in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows for investments that are highly sensitive to interest rate changes, such as mortgage-backed securities, callable bonds and variable-rate debt.

The following were the effective durations of fixed-maturity securities held by the Trust as of December 31, 2012:

	Fair Value	Effective Duration
U.S. Treasuries	\$ 203,805	3.60
U.S. Agencies	122,885	5.07
U.S. Agency MBS	50,774	2.77
Corporate Bonds	695,770	7.91
Municipal Bonds	44,575	12.22
Foreign Bonds	7,239	8.77
Total	\$ 1,125,048	5.87

The average effective duration of the investment portfolio as of December 31, 2012 and 2011, was 5.87 and 6.30 years, respectively.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note C - Investments (Continued)

Net realized gains on the sale of investments were \$126,449 and net change in unrealized losses on investments were \$(40,605) for the year ended December 31, 2012. Net realized gains on the sale of investments were \$19,740 and net change in unrealized gains on investments were \$22,754 for the year ended December 31, 2011.

Note D - Administrative Services Provided by VLCT

The accompanying financial statements represent the general operations of the Trust and do not include the operations and financial condition of VLCT or other affiliated organizations.

VLCT provides staff, office space and equipment usage to the Trust. The following VLCT expenses are attributable to the Trust.

- Salary and benefits for administrative staff including finance, human resource, production and general administrative support
- Office costs including all building-related expenses and insurances
- Equipment and communications costs
- Printing and supplies
- Travel and training for administrative functions
- Non-Trust Officers costs
- Contracted service
- Dues and subscriptions for administrative staff
- Services provided for administrative activities
- Miscellaneous costs related to administrative activities

For the years ended December 31, 2012 and 2011, expenses allocated to the Trust were \$674,587 and \$679,298 for administrative services and \$23,423 and \$22,838 was paid for auto usage reimbursement, respectively. For the years ended December 31, 2012 and 2011, budgeted administrative expenses allocated to the Trust were 14.9% and 15.3%, respectively, of total allocable VLCT expenses. These costs are included as a component of general and administrative expenses on the statement of revenues, expenses and changes in net position.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note E - Insurance Contract

Effective January 1, 2008 through December 31, 2011, the Trust entered into a minimum premium insurance contract with CIGNA, covering the Trust's health benefits plan. This agreement provided for a maximum funding requirement and was determined by multiplying the predetermined premium rates established at the beginning of the plan year (prior to January 1st) by the actual number of monthly insured lives for each month of the plan year.

CIGNA's contract refers to the minimum premium funding arrangement as a "Cash Management Program" (CMP). Under the CMP, the monthly premium rates paid to CIGNA (net of the Trust administrative fees) are divided into five components, as follows:

- (1) **Bank Liability:** This is the portion of the premium that pays claims. Funds are deposited in a bank account that CIGNA draws down to pay claims. This funding includes the current 5% claims margin.
- (2) **Residual:** This pays for CIGNA administrative costs.
- (3) **Access Fee:** This is an administrative charge for provider network access.
- (4) **Experience Protection Benefit:** This is a charge for stop loss insurance.
- (5) **Supplemental Premium:** This is a reserve increase component (used to build reserves for paying claims incurred but not yet paid (IBNP) as of the date of the policy's termination). These funds are held by CIGNA.

The Trust's liability was capped each plan year at 100% of the total rates (bank liability, retention and supplemental premium) times covered lives each month for the year. The liability was limited due to the purchase of the experience protection benefit or "stop loss". Amounts paid for this benefit represented \$507,247 for 2011.

Pursuant to the CMP, the Trust paid CIGNA monthly the amount necessary to pay for retention (residual, access fee, and experience protection benefit) and supplemental premium. The Trust also funded a Trust-owned bank account, as more fully described in Note B, for the actual monthly paid claims, as advised by CIGNA. If claims costs were less than the bank liability amount, the Trust held the funds and received the cash flow benefit. If claim costs were more than the bank liability amount, CIGNA funded the overage.

At the end of each plan year, CIGNA reviewed claims paid and expenses, and reevaluates the IBNP (supplemental premium) they are holding for adequacy. The Trust is not liable to CIGNA for any more than the maximum premium liability for that year (bank liability, retention and full reserves). If there is a deficit, CIGNA carries forward the deficit and attempts to recapture the loss from any surplus in future plan years. For the year ending December 31, 2011 claims exceeded the funding maximum by \$169,996, this amount was received during 2012.

At some future point after termination, CIGNA will do a final accounting. If there is any surplus, the surplus funds will be returned the Trust. If there is a final deficit, CIGNA bears the loss.

VLCT Health Trust, Inc.

Claims Development Information

December 31, 2012

(unaudited)

The table on the following page illustrates how the Trust's earned revenues (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Trust for the last ten years. The rows of the table are defined as follows:

- (1) This line shows the gross of each fiscal year's earned premium revenues, investment and other revenues.
- (2) This line shows each fiscal year's reinsurance premiums (experience protection benefit), these fees are recorded within health insurance administration fees on the statement of revenues, expenses and changes in net position.
- (3) This line shows the net of each fiscal year's earned premium revenues, investment, and other revenues.
- (4) This shows each fiscal year's other operating costs of the Trust including overhead and claims expense not allocable to individual claims.
- (5) This line shows the Trust's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event triggered coverage under the contract occurred (called policy year).
- (6) This line shows the amount of the HMO premiums included in total estimated claims and expenses.
- (7) This section of rows shows the cumulative amounts paid as of the end of successive years for each policy year.
- (8) This section of rows shows how each policy year's incurred claims increased or decreased as of the end of the successive years. This annual re-estimation is the result of new information received on known claims, as well as emergence of new claims not previously known.

The columns of the table show data for successive policy years.

VLCT Health Trust, Inc.

Ten-Year Claims Development Information

December 31, 2012

(unaudited)

Fiscal and Policy Year Ended (in thousands of dollars)										
	CIGNA Retrospective			CIGNA	BC/BS Modified Retrospective					
	2012	2011	2010	2009	Retrospective 2008	2007	2006	2005	2004	2003
(1) Gross commission, premium and investment income	-	23,226	28,051	31,919	28,526	28,116	37,772	35,774	31,832	27,920
(2) Less: Reinsurance expenses	-	507	624	643	587	499	808	598	466	331
(3) Net earned premiums and investment income	-	22,719	27,427	31,276	27,939	27,617	36,964	35,177	31,366	27,589
(4) Unallocated expenses	-	3,140	3,735	5,289	8,010	4,945	4,923	4,177	3,646	3,107
(5) Estimated losses and allocated expenses incurred, net at the end of year:	-	20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408
(6) HMO Premiums included in Total Estimated Claims and Expenses	-	-	-	-	-	-	2,121	2,163	1,974	2,608
(7) Paid (Cumulative) as of:										
End of policy year	-	19,855	23,335	25,607	20,341	21,038	31,404	28,127	24,602	23,293
One year later		20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408
(8) Reestimated incurred losses and expenses										
End of policy year	-	20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408
One year later		20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408

VLCT Health Trust, Inc.

Reconciliation of Claim Liabilities

December 31, 2012

(unaudited)

	<u>Total</u>	
	<u>2012</u>	<u>2011</u>
Claims payable for claims at beginning of year	\$ 243,784	\$ 327,102
Incurred claims:		
Current year	-	20,098,971
Prior years	-	-
Total claims incurred	<u>-</u>	<u>20,098,971</u>
Claim payments:		
Current year	-	19,855,187
Prior years	<u>239,473</u>	<u>327,102</u>
Total claims paid	<u>239,473</u>	<u>20,182,289</u>
Claims payable at end of year	<u>\$ 4,311</u>	<u>\$ 243,784</u>

VLCT Health Trust, Inc.

Schedule of Revenues and Expenses Budget to Actual

Year ended December 31, 2012

(unaudited)

	<u>Budget</u>	<u>Actual</u>	<u>Variance Over/(Under)</u>
REVENUES			
Commissions	\$ 818,270	\$ 728,916	\$ (89,354)
Administration Fee - Dental	29,000	36,298	7,298
Administration fees - Disability/Life	41,000	41,108	108
PACIF share of wellness contract	152,875	138,601	(14,274)
Other income	8,000	3,130	(4,870)
Trust interest	-	54,154	54,154
Change in fair value	-	85,844	85,844
Total Revenues	<u>1,049,145</u>	<u>1,088,051</u>	<u>38,906</u>
EXPENSES			
Administration - Cost Center			
VLCT Administration	268,000	247,186	(20,814)
Audit/Accounting	20,000	17,286	(2,714)
Legal Services	5,000	1,105	(3,895)
Consulting Services	1,000	-	(1,000)
Administration Contracts	40,000	48,050	8,050
Board of Directors	12,000	10,131	(1,869)
Insurance	8,000	12,791	4,791
Investment Management	4,000	3,279	(721)
Investment Consulting	3,500	1,713	(1,787)
Bank Costs	3,300	1,729	(1,571)
Dues/Subscriptions	11,500	11,749	249
Travel/Training - Staff	5,000	6,636	1,636
Travel/Training - Board	3,000	1,217	(1,783)
Vehicle Expenses	1,000	1,307	307
Office Supplies and Equipment	100	-	(100)
Printing	500	35	(465)
Promotional	100	643	543
Miscellaneous	100	-	(100)
Total Administration	<u>386,100</u>	<u>364,857</u>	<u>(21,243)</u>
Member Relations - Cost Center			
VLCT Administration	300,000	277,533	(22,467)
Legal Services	-	-	-
Dues/Subscriptions	600	274	(326)
Travel/Training - Staff	4,500	5,241	741
Member Training	1,000	275	(725)
Vehicle Expenses	6,000	12,189	6,189
Printing	3,500	-	(3,500)
Communication	2,500	-	(2,500)
Office Supplies and Equipment	100	-	(100)
Promotional	1,000	333	(667)
Miscellaneous	100	-	(100)
Total Member Relations	<u>319,300</u>	<u>295,845</u>	<u>(23,455)</u>

VLCT Health Trust, Inc.

Schedule of Revenues and Expenses Budget to Actual (Continued)

(unaudited)

	<u>Budget</u>	<u>Actual</u>	<u>Variance Over/(Under)</u>
Wellness - Cost Center			
VLCT Administration	162,000	149,868	(12,132)
Consulting Services	-	-	-
Dues/Subscriptions	750	129	(621)
Travel/Training - Staff	6,000	2,423	(3,577)
Member Training	40,000	25,558	(14,442)
Invest EAP	81,000	79,115	(1,885)
Vehicle Expenses	10,000	9,927	(73)
Program Supplies	500	-	(500)
Printing	5,000	2,712	(2,288)
Leader Program	30,000	31,422	1,422
Miscellaneous	500	750	250
Total Wellness	<u>335,750</u>	<u>301,904</u>	<u>(33,846)</u>
 Total Expenses	 <u>1,041,150</u>	 <u>962,606</u>	 <u>(78,544)</u>
 Excess of Revenues over Expenses	 <u>\$ 7,995</u>	 <u>\$ 125,445</u>	 <u>\$ 117,450</u>