

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

*Years ended December 31, 2013 and 2012
with Report of Independent Auditors*

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

Years ended December 31, 2013 and 2012

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Report of Independent Auditors

Board of Directors
VLCT Health Trust, Inc.

We have audited the accompanying financial statements of VLCT Health Trust, Inc., which comprise the balance sheets as of December 31, 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.

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 financial position of VLCT Health Trust, Inc. as of December 31, 2013 and 2012 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 - 11 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 VLCT Health Trust, Inc.'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.

Emphasis of Matter

As more fully described in Note A, effective January 1, 2014, VLCT Health Trust, Inc. will no longer facilitate the purchase of medical insurance for members with fifty or fewer employees. VLCT Health Trust, Inc.'s operations subsequent to that date will consist of providing dental and vision coverage, life and disability insurance and member support services for all members, as well as providing medical insurance to large group members through 2016. Management and the Board will continue to evaluate the needs of its members and will respond accordingly. Management does not believe that any adjustments to the carrying values of assets and liabilities as reported in these financial statements are required as a result of these circumstances. Our opinion is not modified for this matter.

A handwritten signature in cursive script that reads "Johnson Lambert LLP".

Burlington, Vermont
April 28, 2014

Vermont firm registration: 092-0000267

VLCT Health Trust, Inc.

Management's Discussion and Analysis

Years ended December 31, 2013 and 2012

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, 2013, 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 \$2,074,295 as of December 31, 2013. This compares with a net position of \$2,272,314 and \$2,146,869 as of December 31, 2012 and 2011, respectively. Net position was unrestricted for 2013, 2012 and 2011.
- Total assets decreased from 2012 by \$214,931 or 9%, offset slightly by a decrease in liabilities of \$16,912 or 84%. Prior year surplus was used in 2013 to support continuing operations as the state takes over the business of providing health care insurance. Both cash and receivables were reduced as a result of the transition.
- An operating loss of \$184,277 was increased by an investment earnings loss of \$13,742, resulting in a reduction in net position of \$198,019 for 2013. The operating loss was budgeted and resulted in lower commissions from the transition to the new state health care system. Expenses that exceeded the commission revenues were anticipated and budgeted in order to continue to provide the transition services to members as the Trust phases out of its role as a provider of health care insurance. The decrease in investment income was primarily from unrealized losses in the fixed income portfolio.
- Net position decreased by \$198,019 as of December 31, 2013 compared with an increase of \$125,445 in 2012 and a decrease of \$520,842 in 2011. Operating losses for 2013, 2012 and 2011 were \$184,277, \$7,832 and \$624,523, respectively. In both 2011 and 2012, these losses were offset by investment earnings, resulting in a positive change in net position in 2012. Investment earnings for 2011, however, were not sufficient to fully cover the operating loss, and in 2013 an investment loss increased 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)

Overview of the Trust's Financial Statements (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 VLCT 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, 2013 and 2012 and financial development during 2013 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)

Overview of the Trust's Financial Statements (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 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 the statements of revenues, expenses and changes in net position.

The statements of cash flows outline the cash flow resulting from the operating, 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 revenue and expenses, comparing budget to actual for the year ending December 31, 2013. 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 statements of net position:

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>	<u>Percentage</u> <u>Change</u>	<u>December 31,</u> <u>2011</u>	<u>Percentage</u> <u>Change</u>
Cash and investments	\$ 1,985,947	\$ 2,101,106	(5)%	\$ 2,291,460	(8)%
Other assets	<u>91,687</u>	<u>191,459</u>	(52)%	<u>501,437</u>	(62)%
Total assets	2,077,634	2,292,565	(9)%	2,792,897	(18)%
Claims payable	-	4,311	(100)%	243,784	(98)%
Other liabilities	<u>3,339</u>	<u>15,940</u>	(79)%	<u>402,244</u>	(96)%
Total liabilities	3,339	20,251	(84)%	646,028	(97)%
Net position					
Unrestricted	<u>2,074,295</u>	<u>2,272,314</u>	(9)%	<u>2,146,869</u>	6 %
Total net position	<u>\$ 2,074,295</u>	<u>\$ 2,272,314</u>	(9)%	<u>\$ 2,146,869</u>	6 %

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

As of December 31, 2013, total assets decreased by 9% from \$2,292,565 to \$2,077,634. This compares with a decrease of 18% in 2012 and 33% in 2011. The overall decrease in total assets from 2011 to 2013 reflects the changes to operations. The large operating loss in 2011 resulted from higher claim costs, which also 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 held in the working fund balance that was released in 2013, significantly reducing the scope of the financial activity and budget.

Cash and investments decreased from 2012 to 2013 by 5%, or \$115,159. Cash and investments decreased from 2011 to 2012 by 8%, and decreased from 2010 to 2011 by 30%. At the end of 2011 and into 2012, equity investments were liquidated in preparation for the transition to the carrier choice model, as cash flow from commissions took a full quarter to reach the level necessary to sustain operations. No liquidation was necessary going into 2013, however a change in the investment policy moved the remaining equities into the fixed income portfolio, realizing the gains from the sale and reducing overall market risk. This also allows more flexibility if further liquidation is necessary as the Trust reconfigures its operations. Use of prior year surplus offset additions to the investment portfolio from the equity sale, reducing combined cash and investments in 2013.

As of December 31, 2013, total liabilities decreased by 84% or \$16,912. At the end of 2012, total liabilities decreased by 97% and in 2011 by 57%. The decrease in 2011 was attributable to a reduction in unearned income; with the change to the carrier choice revenue model, the Trust did not collect health insurance premiums in 2012, and, therefore, there were no payments made by members for a January 1st billing. The 2012 decrease related to the elimination of claims payable at year-end as the Trust moved to carrier choice (with the exception of the residual left in the working fund for straggling claims). The small decrease in 2013 reflects the liquidation of the working fund.

Net position, as discussed in the Highlights section above, decreased by \$198,019 as of December 31, 2013 compared with a increase of \$125,445 in 2012 and a decrease of \$520,842 in 2011. Investment earnings offset operating deficits in 2012 and reduced the large operating loss in 2011. In 2013, an unrealized loss on investments increased the operating loss.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

The following table summarizes the statements 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>2013</u>	<u>2012</u>	<u>Percentage Change</u>	<u>2011</u>	<u>Percentage Change</u>
Operating revenues:					
Commission income	\$ 619,479	\$ 728,916	(15)%	\$ -	100 %
Health insurance premiums	-	-	-	21,837,556	(100)%
Administrative fees	94,248	77,406	22 %	1,056,347	(93)%
Other revenues	<u>157,613</u>	<u>141,731</u>	11 %	<u>218,772</u>	(35)%
Total operating revenues	871,340	948,053	(8)%	23,112,675	(96)%
Operating expenses:					
Claims paid	-	-	-	20,098,971	(100)%
Health insurance administration & insurance premiums paid	-	-	-	2,382,902	(100)%
Other operating expenses	<u>1,055,617</u>	<u>955,885</u>	10 %	<u>1,255,325</u>	(24)%
Total operating expenses	<u>1,055,617</u>	<u>955,885</u>	10 %	<u>23,737,198</u>	(96)%
Operating loss	<u>(184,277)</u>	<u>(7,832)</u>	2,253 %	<u>(624,523)</u>	(99)%
Non-operating revenues:					
Investment (loss) income (net of fees)	<u>(13,742)</u>	<u>133,277</u>	(110)%	<u>103,681</u>	29 %
Change in net position	(198,019)	125,445	(258)%	(520,842)	(124)%
Net position, beginning of year	<u>2,272,314</u>	<u>2,146,869</u>	6 %	<u>2,667,711</u>	(20)%
Net position, end of year	<u>\$ 2,074,295</u>	<u>\$ 2,272,314</u>	(9)%	<u>\$ 2,146,869</u>	6 %

Trust operations for 2013 resulted in a net operating loss of \$184,277. The net operating loss in 2012 and 2011 was \$7,832 and \$624,523, respectively. Net investment loss of \$13,742 (\$56,992 of which was the change in fair value, both realized and unrealized) increased the operating loss and resulted in a decrease in net position of \$198,019 as of December 31, 2013. Realized gains in 2013 were primarily from fixed income, as the equities were liquidated at the end of 2012 in order to reduce risk as the Trust made decisions about its future. The health care reform changes at both the federal and state levels will impact the Trust in a way that may require more liquidity. Investment income for 2011 and 2012 was \$103,681 and \$133,277, respectively, including market gains of \$42,494 and \$85,844 respectively.

Total operating revenues in 2013 were \$871,340. Total revenue from operations is down \$76,713 compared to 2012, with much of this decrease attributable to the anticipated loss of the new business bonus revenue. While health premium commissions at the end of 2013 decreased by

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

\$109,437 or 15%, other commissions (including dental) increased by \$16,842 or 22% due to increased participation. Miscellaneous income and the wellness contract reimbursements increased over last year as well, further reducing the decrease in health premium commissions.

Investment income net of fees decreased by \$147,019 (110%) from 2012, with unrealized losses exceeding interest and dividends and realized gains, resulting in a cumulative net investment loss of \$13,742. The Trust realized a calendar year-to-date return of -0.59%, with fixed income outperforming its benchmark by 0.46%. Concerns in 2013 that the Federal Reserve would begin easing off its monetary stimulus program roiled the fixed income market and led to increases in the ten-year treasury rate, resulting in unrealized losses for fixed income investments.

Operating expenses increased by \$99,732 or 10% from last year. These expenses include the costs of administration, marketing and wellness initiatives. Most of the increase over last year (\$63,739) is from the contract for services with VLCT, which increased by 9% from 2012 to 2013 but included a provision to pay for indirect costs as budgeted with no true-up to actual indirect costs. In 2012, more money was returned at year-end, reducing the total cost. The balance of the overall operating expense increase is due to the change in accounting practice to book the wellness program expenses to the appropriate year. In previous years, supplies were ordered in advance of the budget year for which they were to be used and booked as a current year expense. In 2012 this was corrected, and expenses associated with 2013 programs were booked as prepaid expenses on the balance sheet and expensed in the first quarter of 2013. The total cost for these prepaid items was about \$22,000.

The following table presents a budget to actual comparison in summarized form for the year ended December 31, 2013. The purpose of this summary is to show the variance between what was budgeted and what was actually received or spent. Revenues and expenses from operations are combined with the results from investments.

	<u>Budget</u>	<u>Actual</u>	<u>% Variance</u>
Operating revenues:			
Commissions	\$ 647,521	\$ 619,479	(4)%
Administrative fees	97,000	94,248	(3)%
Other revenues	<u>154,373</u>	<u>157,613</u>	<u>2 %</u>
Total operating revenues	898,894	871,340	(3)%
Operating expenses:			
Operating expenses - all cost centers	<u>1,121,567</u>	<u>1,055,617</u>	<u>(6)%</u>
Total operating expenses	<u>1,121,567</u>	<u>1,055,617</u>	<u>(6)%</u>
Operating excess of expenses over revenues	(222,673)	(184,277)	(17)%
Non-operating - investment income	<u>-</u>	<u>(13,742)</u>	<u>100 %</u>
Excess of expenses over revenues	<u>\$ (222,673)</u>	<u>\$ (198,019)</u>	<u>(11)%</u>

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

Total operating revenue for 2013 was \$27,554 or 3.0% below budget, primarily due to lower than expected commissions. The reduced commissions resulted from a combination of plan changes among members and approved rate increases that came in below what was submitted and budgeted for. Blue Cross filed rates were a 9.9% increase but only 6.2% was approved. Commissions and administrative fees charged to members make up about 82% of the total revenue recognized for 2013.

Total operating expenses, excluding investment and banking fees were below budget by \$65,950 or 6% at the end of 2013, mainly from savings in benefits administration contract costs (\$26,333), VLCT agreement costs (\$12,042), and board costs (\$9,951). Lower member participation and conservative budgeting contributed to the lower benefits administration costs, mainly the COBRA administration. The board costs were reduced with fewer meetings, and the VLCT agreement costs were below budget due to the contractual true-up of actual direct costs to budget with the difference returned to the Trust.

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

- Legal services were under budget by about \$4,532 or 91% with very little need for legal consulting during the year.
- Combined travel and vehicle expenses exceeded budget by \$3,534 or 11% primarily due to the increase in member visits from the transition to the new state health insurance program, necessitating heavier member assistance efforts. This was offset by member training costs that were under budget by \$4,747, with the funds diverted to providing assistance to individual members on-site.

Outlook / Economic Factors

The Vermont health insurance delivery system continues its evolution towards a state-operated single payer/universal health system anticipated to begin in 2017. The state launched Vermont Health Connect (VHC), its federally mandated health benefits exchange, in October 2013 for coverage effective January 1, 2014. Most Vermont municipalities have fifty or fewer employees and thus were mandated to purchase health insurance through VHC for 2014.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Outlook / Economic Factors (Continued)

In VHC, insurance agent commissions will no longer be paid by the health insurance company. Insurance agent commissions in VHC are set by and collected from the employer by the state and then remitted to the insurance agent. These costs are in addition to health insurance premiums and are only paid if the employer chooses to work with a state approved insurance agent. The state set commission amounts are considerably less than previous broker compensation from the health insurer. Because small businesses can obtain similar assistance from a state funded "Navigator" at no cost, it is expected that insurance agents will receive much lower revenue from this segment of the health insurance market. The Health Trust decided not to offer broker services to VHC, but rather to provide assistance to VLCT members moving to Vermont Health Connect at "no cost."

As a result of the launch of VHC, the Trust has made significant changes to its business model for 2014 and forward. A large portion of the Trust's revenue comes from commissions on health insurance plans. With the migration to VHC, the bulk of this revenue flow has stopped and projected revenues dropped by 63%. The Trust correspondingly reduced its operating budget by 62%. This decrease resulted from reductions in staffing, trimming expenses and transferring the Health Promotion/Wellness program to PACIF. Previously, the costs of this program were shared between the Trust and PACIF.

The Trust is devoted to helping all VLCT member municipalities with the transition to VHC. To fund this project, the Trust has committed to use a portion of its net position to fund its program while the transition takes place, even though there is diminishing revenue from the health insurance related portion of the Trust's revenue stream. In addition, VLCT has committed some funding to help with the transition process in recognition of the fact that not all members of VLCT are members of the Trust. The Trust Board also committed to maintaining a net position of at least \$1 million as Vermont moves to its universal care/single payer system, Green Mountain Care. These funds will provide for the future possibility that, if Green Mountain Care does not work as planned, there will be funds available to reconstitute the health insurance programs for VLCT members.

The 2014 Trust budget anticipates a reduction in net position of \$101,924.

The Trust continues to partner with Hickok Boardman Group Benefits (HBGB) to provide health insurance brokerage services to municipal employers with more than 50 employees, as well as continuing with the sponsored life and disability program. The Trust continues to offer group rates for dental, vision, life, disability and long-term care insurances, as well as assistance with cafeteria plans.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Outlook / Economic Factors (Continued)

The Trust and the VLCT Unemployment Trust Boards met in March 2014 to discuss the possibility of a merger of the two trusts, as well as new business opportunities. Based on these discussions, each board voted unanimously to move forward with a merger. The merger would need final approval of the board and membership of each trust before it could be completed. The target date for a merger is January 1, 2015.

It is management's strong belief that the Trust's net position and funding sources will be adequate to carry the Trust, or its successor organization, through the challenging and exciting process of healthcare 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>2013</u>	<u>2012</u>
Assets		
Cash and cash equivalents	\$ 441,996	\$ 976,058
Fixed-maturity securities, at fair value	1,543,951	1,125,048
Working fund deposit	-	4,311
Accrued investment income	10,637	10,234
Accounts receivable	53,002	-
Net amounts due from related entities	23,643	143,028
Prepaid expenses	<u>4,405</u>	<u>33,886</u>
 Total Assets	 <u>\$ 2,077,634</u>	 <u>\$ 2,292,565</u>
 Liabilities and Net Position		
Liabilities		
Claims payable	\$ -	\$ 4,311
Accounts payable and accrued expenses	<u>3,339</u>	<u>15,940</u>
Total liabilities	3,339	20,251
 Net Position		
Unrestricted	<u>2,074,295</u>	<u>2,272,314</u>
 Total Liabilities and Net Position	 <u>\$ 2,077,634</u>	 <u>\$ 2,292,565</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>2013</u>	<u>2012</u>
Operating Revenues		
Administration fees - dental	\$ 51,620	\$ 36,298
Administration fees - disability/life	42,628	41,108
PACIF share of wellness contract	146,373	138,601
Commission income	619,479	728,916
Other income	<u>11,240</u>	<u>3,130</u>
Total operating revenues	871,340	948,053
Operating Expenses		
Leader program	32,100	31,422
General and administrative expenses	<u>1,023,517</u>	<u>924,463</u>
Total operating expenses	1,055,617	955,885
Operating loss	(184,277)	(7,832)
Non-Operating Revenues (Expenses)		
Investment income	51,878	54,154
Investment income - net realized (loss) gain and change in fair value	(56,992)	85,844
Investment management fees	(3,946)	(3,279)
Investment consulting fees	(1,488)	(1,713)
Investment banking fees	<u>(3,194)</u>	<u>(1,729)</u>
Net non-operating (expenses) revenues	<u>(13,742)</u>	<u>133,277</u>
Change in Net Position	(198,019)	125,445
Net Position, Beginning of Year	<u>2,272,314</u>	<u>2,146,869</u>
Net Position, End of Year	<u>\$ 2,074,295</u>	<u>\$ 2,272,314</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Statements of Cash Flows

	Years ended December 31,	
	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities		
Receipts for administrative fees and commissions	\$ 713,727	\$ 806,322
Other receipts	253,477	117,925
Payments for claims	(4,311)	(69,477)
Payments from the working fund deposit	4,311	159,138
Payments for administration	<u>(1,068,218)</u>	<u>(1,342,189)</u>
Net cash used in operating activities	(101,014)	(328,281)
Cash Flows from Investing Activities		
Receipts of interest income	51,475	58,804
Investment fees paid	(8,628)	(6,721)
Purchases of investments	(2,023,659)	(883,643)
Proceeds from sales of investments	<u>1,547,764</u>	<u>1,640,423</u>
Net cash (used in) provided by investing activities	(433,048)	808,863
Net change in cash and cash equivalents	(534,062)	480,582
Cash and Cash Equivalents, Beginning of Year	<u>976,058</u>	<u>495,476</u>
Cash and Cash Equivalents, End of Year	<u>\$ 441,996</u>	<u>\$ 976,058</u>
Reconciliation of Operating Income to Net Cash Used in Operating Activities		
Operating Loss	\$ (184,277)	\$ (7,832)
Changes in assets and liabilities:		
Working fund deposit	4,311	159,138
Accounts receivable	(53,002)	40,013
Net amounts due from related entities	119,385	(45,869)
Health insurance administration receivable	-	169,996
Prepaid expenses	29,481	(17,950)
Claims payable	(4,311)	(239,473)
Accounts payable and accrued expenses	<u>(12,601)</u>	<u>(386,304)</u>
Net cash used in operating activities	<u>\$ (101,014)</u>	<u>\$ (328,281)</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Notes to the Financial Statements

Years ended December 31, 2013 and 2012

Note A - Organization and Nature of Operations

Organization

VLCT Health Trust, Inc. (the Trust) was established in 1982 (1) to provide, both 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 Trust moved to a "Carrier Choice" model to provide health coverage for its members. With this approach, the 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 and long-term care insurances, as well as assistance with cafeteria plans.

Effective January 1, 2014, the Trust will no longer facilitate the purchase of medical insurance for members with fifty or fewer employees. The Trust's operations subsequent to that date will consist of providing dental and vision coverage, life and disability insurance and member support services for all members, as well as providing medical insurance to large group members through 2016. Management and the Board will continue to evaluate the needs of its members and will respond accordingly.

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 it is accounted for as a proprietary enterprise fund.

Subsequent Events

The Trust has evaluated subsequent events for disclosure and recognition through April 28, 2014, the date on which these financial statements were available to be issued.

VLCT Health Trust, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

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.

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.

Cash and cash equivalents shown above are held at People's United Bank in 2013 and 2012, as well as Citizens Bank (New England) in 2012. 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 management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

VLCT Health Trust, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

The Trust's carrying amount of cash deposits and the bank balance are as follows at December 31:

	<u>2013</u>		<u>2012</u>	
	<u>Book Balance</u>	<u>Bank Balance</u>	<u>Book Balance</u>	<u>Bank Balance</u>
Insured/FDIC	\$ 250,000	\$ 250,000	\$ 495,476	\$ 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	<u>191,996</u>	<u>198,143</u>	<u>480,582</u>	<u>21,027</u>
Total	<u>\$ 441,996</u>	<u>\$ 448,143</u>	<u>\$ 976,058</u>	<u>\$ 521,027</u>

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

Working Fund Deposit

In accordance with the terms of the contract with CIGNA Healthcare (CIGNA), the Trust was required to maintain a separate account at Citibank, which was utilized solely in connection with the program administered by CIGNA. This account enabled CIGNA to directly withdraw amounts due to fund claims during the year. This contract was terminated effective December 31, 2011, and the remaining deposit balance was released during 2013. The balance of the deposit at December 31, 2012 was \$4,311. The amount due to CIGNA under the cash management program to fund outstanding claims was \$4,311 at December 31, 2012 and was recorded as claims payable on the statements of net position.

Accounts Receivable

Accounts receivable as of December 31, 2013 consist of billed amounts not yet collected for administrative fees and commissions. Management anticipates no uncollectible accounts and, therefore, has not established an allowance for doubtful accounts.

Net Amounts Due From Related Entities

Amounts due from related entities as of December 31, 2013 and 2012 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 2013. As of December 31, 2013, this amount is offset by a payable to VLCT for prepaid insurance expenses paid by VLCT on behalf of the Trust. Management anticipates no uncollectible accounts and, therefore, has not established an allowance for doubtful accounts.

VLCT Health Trust, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Accounts Payable

Accounts payable as of December 31, 2013 and 2012 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 commissions 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.

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

VLCT Health Trust, Inc.

Notes to the Financial Statements (Continued)

Note C - Investments (Continued)

- *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. Government 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, 2013 and 2012.
- *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, 2013. 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.

	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	\$ 82,271	\$ 163,146	\$ 163,664	\$ -	\$ 409,081
U.S. Agencies	-	-	-	136,294	136,294
U.S. Agency MBS	-	35,731	54,133	43,951	133,815
Corporate Bonds	32,078	334,118	235,980	226,750	828,926
Municipal Bonds	-	22,407	7,034	-	29,441
Foreign Bonds	-	-	-	6,394	6,394
Total	\$ 114,349	\$ 555,402	\$ 460,811	\$ 413,389	\$ 1,543,951

VLCT Health Trust, Inc.

Notes to the 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, 2013:

	<u>U.S. Treasuries</u>	<u>U.S. Agencies</u>	<u>U.S. Agency MBS</u>	<u>Corporate Bonds</u>	<u>Municipal Bonds</u>	<u>Foreign Bonds</u>	<u>Total</u>
AAA	\$ -	\$ -	\$ -	\$ 98,035	\$ -	\$ -	\$ 98,035
AA+	409,081	136,294	133,815	41,337	-	-	720,527
AA	-	-	-	46,720	-	-	46,720
AA-	-	-	-	12,015	7,034	-	19,049
A+	-	-	-	24,219	22,407	6,394	53,020
A	-	-	-	132,704	-	-	132,704
A-	-	-	-	126,571	-	-	126,571
BBB+	-	-	-	152,950	-	-	152,950
BBB	-	-	-	71,065	-	-	71,065
BBB-	-	-	-	10,914	-	-	10,914
Not Rated	-	-	-	112,396	-	-	112,396
Total	\$ 409,081	\$ 136,294	\$ 133,815	\$ 828,926	\$ 29,441	\$ 6,394	\$1,543,951

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 are the effective durations of fixed-maturity securities held by the Trust as of December 31, 2013:

	<u>Fair Value</u>	<u>Effective Duration</u>
U.S. Treasuries	\$ 409,081	5.11
U.S. Agencies	136,294	4.90
U.S. Agency MBS	133,815	2.03
Corporate Bonds	828,926	3.79
Municipal Bonds	29,441	4.13
Foreign Bonds	<u>6,394</u>	<u>7.08</u>
Total	\$ 1,543,951	3.75

VLCT Health Trust, Inc.

Notes to the Financial Statements (Continued)

Note C - Investments (Continued)

The average effective duration of the investment portfolio as of December 31, 2013 and 2012 was 3.75 and 5.87 years, respectively.

Net realized gains on the sale of investments were \$31,490 and net change in unrealized losses on investments were \$(88,482) for the year ended December 31, 2013. 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.

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. 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 services
- Dues and subscriptions for administrative staff
- Services provided for administrative activities
- Miscellaneous costs related to administrative activities

For the years ended December 31, 2013 and 2012, expenses allocated to the Trust were \$738,326 and \$674,587 for administrative services and \$7,546 and \$23,423 for auto usage reimbursement, respectively. For the years ended December 31, 2013 and 2012, budgeted administrative expenses allocated to the Trust were 18.0% and 14.9%, 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.

Note E - Subsequent Event

VLCT Health Trust, Inc. and VLCT Unemployment Insurance Trust, Inc. Boards of Directors met in March 2014 to discuss the possibility of merging the two trusts, as well as new business opportunities. Based on these discussions, each Board voted unanimously to move forward with a merger. The merger would need final approval of the Board and membership of each trust before it could be completed. The target date for a merger is January 1, 2015.

VLCT Health Trust, Inc.

Claims Development Information

December 31, 2013

(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, 2013

(unaudited)

Fiscal and Policy Year Ended (in thousands of dollars)										
	CIGNA Retrospective					CIGNA Retrospective	BC/BS Modified Retrospective			
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
(1) Gross commission, premium and investment income	-	-	23,226	28,051	31,919	28,526	28,116	37,772	35,774	31,832
(2) Less: Reinsurance expenses	-	-	507	624	643	587	499	808	598	466
(3) Net earned premiums and investment income	-	-	22,719	27,427	31,276	27,939	27,617	36,964	35,177	31,366
(4) Unallocated expenses	-	-	3,140	3,735	5,289	8,010	4,945	4,923	4,177	3,646
(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
(6) HMO Premiums included in Total Estimated Claims and Expenses	-	-	-	-	-	-	-	2,121	2,163	1,974
(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
One year later	-	-	20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890
(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
One year later	-	-	20,099	23,663	25,901	20,122	23,240	33,742	30,578	26,890

VLCT Health Trust, Inc.

Reconciliation of Claim Liabilities

December 31, 2013

(unaudited)

	<u>Total</u>	
	<u>2013</u>	<u>2012</u>
Claims payable at beginning of year	\$ 4,311	\$ 243,784
Incurred claims:		
Current year	-	-
Prior years	<u>-</u>	<u>-</u>
Total claims incurred	<u>-</u>	<u>-</u>
Claim payments:		
Current year	-	-
Prior years	<u>4,311</u>	<u>239,473</u>
Total claims paid	<u>4,311</u>	<u>239,473</u>
Claims payable at end of year	<u>\$ -</u>	<u>\$ 4,311</u>

VLCT Health Trust, Inc.

Schedule of Revenues and Expenses Budget to Actual

Year ended December 31, 2013

(unaudited)

	<u>Budget</u>	<u>Actual</u>	<u>Variance Over/(Under)</u>
REVENUES			
Commissions	\$ 647,521	\$ 619,479	\$ (28,042)
Administration Fees - Dental	48,000	51,620	3,620
Administration Fees - Disability/Life	49,000	42,628	(6,372)
PACIF Share of Wellness Contract	150,373	146,373	(4,000)
Other Income	4,000	11,240	7,240
Trust interest	-	51,878	51,878
Change in Fair Value	-	(56,992)	(56,992)
Total Revenues	<u>898,894</u>	<u>866,226</u>	<u>(32,668)</u>
EXPENSES			
Administration - Cost Center			
VLCT Direct Costs	205,542	203,723	(1,819)
VLCT Administrative Costs	115,664	115,664	-
Audit/Accounting	20,000	19,556	(444)
Legal Services	5,000	468	(4,532)
Consulting Services	2,000	-	(2,000)
Administration Contracts	80,000	53,667	(26,333)
Board of Directors	24,000	14,049	(9,951)
Insurance	15,000	12,263	(2,737)
Investment Management	3,200	3,946	746
Investment Consulting	1,400	1,488	88
Bank Costs	3,000	3,194	194
Dues/Subscriptions	11,500	11,083	(417)
Staff Travel - Conferences	5,000	3,569	(1,431)
Staff Travel - Member Outreach	300	2,078	1,778
Travel/Training - Board	3,000	1,778	(1,222)
Vehicle Expenses	1,000	196	(804)
Printing	500	218	(282)
Town Fair	750	-	(750)
Total Administration	<u>496,856</u>	<u>446,940</u>	<u>(49,916)</u>
Member Relations - Cost Center			
VLCT Direct Costs	155,367	146,778	(8,589)
VLCT Administrative Costs	116,299	116,299	-
Dues/Subscriptions	600	801	201
Staff Travel - Conferences	4,500	1,910	(2,590)
Staff Travel - Member Outreach	3,000	11,041	8,041
Member Training	5,000	253	(4,747)
Vehicle Expenses	6,000	7,222	1,222
Printing	1,000	-	(1,000)
Communication	1,000	-	(1,000)
Office Supplies and Equipment	100	-	(100)
Promotional	1,000	1,415	415
Miscellaneous	100	-	(100)
Total Member Relations	<u>293,966</u>	<u>285,719</u>	<u>(8,247)</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 Direct Costs	93,944	92,310	(1,634)
VLCT Administrative Costs	63,551	63,551	-
Dues/Subscriptions	750	1,807	1,057
Staff Travel - Conferences	4,500	410	(4,090)
Staff Travel - Member Outreach	8,000	9,407	1,407
Member Training	42,000	48,105	6,105
Invest EAP	82,000	81,144	(856)
Vehicle Expenses	-	128	128
Program Supplies	500	-	(500)
Printing	5,000	1,886	(3,114)
Leader Program	30,000	32,100	2,100
Miscellaneous	500	738	238
Total Wellness	<u>330,745</u>	<u>331,586</u>	<u>841</u>
 Total Expenses	 <u>1,121,567</u>	 <u>1,064,245</u>	 <u>(57,322)</u>
 Excess of Expenses over Revenues	 <u>\$ (222,673)</u>	 <u>\$ (198,019)</u>	 <u>\$ 24,654</u>