

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

*Years ended December 31, 2010 and 2009
with Report of Independent Auditors*

VLCT Health Trust, Inc.

Audited Financial Statements
with Supplementary Information

Years ended December 31, 2010 and 2009

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Report of Independent Auditors

The Board of Directors
VLCT Health Trust, Inc.

We have audited the accompanying statements of net assets of VLCT Health Trust, Inc. ("the Trust") as of December 31, 2010 and 2009 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes the consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

The accounting principles generally accepted in the United States require that the management's discussion and analysis on pages 3 - 9 and the accompanying financial information on pages 23 - 25 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board which has determined 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, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the Trust's basic financial statements as a whole. The supplementary information on pages 26 - 27 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and accordingly, we do not express an opinion or provide any assurance on it.

Johnson Lambert & Co. LLP

Burlington, Vermont
May 12, 2011
Vermont firm registration: 092-0000267

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VLCT Health Trust, Inc.

Management's Discussion and Analysis

Years ended December 31, 2010 and 2009

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, 2010, 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 \$2,667,711 as of December 31, 2010, with no designated net assets. This compares with net assets of \$2,638,793 and \$2,552,753 as of December 31, 2009 and 2008, respectively, also with no designated funds.
- Net Assets increased by \$28,918 and \$86,040 as of December 31, 2010 and 2009, respectively, while premium revenues were below expectations for these years, claims and administration expenses were also below anticipated amounts.

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 internally 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).

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 Leader Program expenses are included in the health promotion program but are fully funded with premium administration fees (approximately 1% of billed premiums).

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

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

These statements present the Trust's status at December 31, 2010 and 2009 and financial development during 2010 for all cost centers combined.

The statements of net assets 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 assets (the Trust's equity). The Trust has no debt.

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

The statements of cash flows outlines the cash flow resulting from operations, investment, and financing activities of the Trust showing how the financial resources were used during the course of the budget 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 more detailed analysis of certain accounts.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

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, 2010. 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 assets:

	December 31, 2010	December 31, 2009	Percentage Change	December 31, 2008	Percentage Change
Cash and Investments	\$ 3,265,620	\$ 4,247,189	(23.11)%	\$ 3,658,129	16.10 %
Other assets	<u>917,434</u>	<u>255,355</u>	259.28 %	<u>611,899</u>	(58.27)%
Total assets	4,183,054	4,502,544	(7.10)%	4,270,028	5.45 %
Claims Payable	327,102	293,015	11.63 %	-	100.00 %
Other Liabilities	<u>1,188,241</u>	<u>1,570,736</u>	(24.35)%	<u>1,717,275</u>	(8.53)%
Total liabilities	1,515,343	1,863,751	(18.69)%	1,717,275	8.53 %
Net assets					
Unrestricted	<u>2,667,711</u>	<u>2,638,793</u>	1.10 %	<u>2,552,753</u>	3.37 %
Total net assets	<u>\$ 2,667,711</u>	<u>\$ 2,638,793</u>	1.10 %	<u>\$ 2,552,753</u>	3.37 %

As of December 31, 2010, total assets decreased by 7.1% from \$4.5 million to \$4.2 million. As of December 31, 2009, total assets increased by 5.5% from \$4.3 million to \$4.5 million. As of December 31, 2008, total assets decreased 15.9% from \$5.1 million to \$4.3 million.

Cash and investments overall decreased from 2009 to 2010 by 23.1%, or \$981,569. Cash and investments overall increased from 2008 to 2009 by 16.1%, or \$589,060, as compared to a decrease from 2007 to 2008 by 26.0%, or \$1,288,044. Cash and investments includes various checking and money market accounts, and an investment portfolio that comprises about 56.4%, 38.9% and 45.3% of the total as of December 31, 2010, 2009 and 2008, respectively.

Other assets increased 259.3% or \$662,079 from 2009 to 2010. This increase relates to a receivable from CIGNA HealthCare ("CIGNA") of \$710,280 for claims paid above the maximum liability amount. From 2008 to 2009, other assets decreased 58.3% or \$356,544. This decrease was due to the Trust recording a receivable at December 31, 2008 of \$219,860 for claims paid above the maximum liability amount. There was no receivable recorded in 2009.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

As of December 31, 2010, total liabilities decreased by 18.7% or \$348,408. Due to funding arrangements with CIGNA there is also a small liability for the bank margin at December 31, 2010 for \$1,574 as compared to a liability due to CIGNA at December 31, 2009 for \$525,663. As of December 31, 2009, total liabilities increased by 8.5% or \$146,476. At December 31, 2008, total liabilities decreased by 26.3% or \$612,835.

Unearned income (included in other liabilities above or found on the statement of net assets) at December 31, 2010 represents premiums billed in December 2010, for January 2011 coverage.

The following table summarizes the statement of revenues, expenses and changes in net assets. It shows net income (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 assets.

	<u>2010</u>	<u>2009</u>	Percentage Change	<u>2008</u>	Percentage Change
Operating revenues:					
Health insurance premiums	\$26,578,236	\$30,217,190	(12.04)%	\$27,458,955	10.04 %
Administrative fees	1,095,461	1,249,308	(12.31)%	945,821	32.09 %
Other revenues	<u>205,929</u>	<u>207,378</u>	(0.70)%	<u>218,358</u>	(5.03)%
Total operating revenues	27,879,626	31,673,876	(11.98)	28,623,134	10.66 %
Operating expenses:					
Claims paid	23,662,504	25,900,524	(8.64)%	20,122,067	28.72 %
Health insurance administration & insurance premiums paid	3,065,602	4,544,579	(32.54)%	7,245,680	(37.28)%
Operating expenses	<u>1,283,248</u>	<u>1,377,872</u>	(6.87)%	<u>1,335,705</u>	3.16 %
Total operating expenses	<u>28,011,354</u>	<u>31,822,975</u>	(11.98)%	<u>28,703,452</u>	10.87 %
Operating loss	<u>(131,728)</u>	<u>(149,099)</u>	(11.65)%	<u>(80,318)</u>	85.64 %
Non-operating revenues (expenses):					
Investment income (loss) (net of fees)	<u>160,646</u>	<u>235,139</u>	(31.68)%	<u>(112,866)</u>	(308.33)%
Change in net assets	28,918	86,040	(66.39)%	(193,184)	(144.54)%
Net assets, beginning of year	<u>2,638,793</u>	<u>2,552,753</u>	3.37 %	<u>2,745,937</u>	(7.04)%
Net assets, end of year	<u>\$ 2,667,711</u>	<u>\$ 2,638,793</u>	1.10 %	<u>\$ 2,552,753</u>	3.37 %

Trust operations for 2010 resulted in a net operating loss (the deficiency of revenue under expenses, not including investment income) of \$131,728. The net operating loss in 2009 was \$149,099, and the net operating loss in 2008 was \$80,318. Net investment gains of \$160,646 (\$106,535 of which was the change in fair value) offset to the operating loss and resulted in a change in net assets of \$28,918 as of December 31, 2010. The change in net assets was \$86,040 and \$(193,184), as of December 31, 2009 and 2008, respectively.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Revenues from premiums and administrative fees decreased in 2010, resulting in an overall decrease in operating revenues of \$3,794,250 or 12.0% from 2009 to 2010. In 2009, operating revenues increased by \$3,050,742 or 10.7% from 2008 to 2009, and in 2008, operating revenues increased from 2007 by \$729,334 or 2.6%. At the same time, operating expenses decreased by \$3,811,621 or 12.0% from 2009 to 2010. Operating expenses increased by \$3,119,523 or 10.9% from 2008 to 2009 and \$41,937 or less than 1% from 2007 to 2008. The 2010 health insurance administration reflects the third year supplemental premium for the CMP arrangement. Under this funding agreement, the Trust's liability for claims each year is capped. At December 31, 2010, the Trust had not funded the maximum amount and a balance of \$1,574 was due to CIGNA for the 2010 plan year. At December 31, 2009, the balance due was \$525,663. Net investment income for 2010 was down \$74,493 from 2009. Net investment income increased \$348,005 from 2008 to 2009.

The following table presents a budget to actual comparison in summarized form for the year ended December 31, 2010. 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:			
Health insurance premiums	\$ 32,145,463	\$ 26,578,236	(17.32)%
Administrative fees	1,324,361	1,095,461	(17.28)%
Other revenues	<u>222,250</u>	<u>205,929</u>	<u>(7.34)%</u>
Total operating revenues	33,692,074	27,879,626	(17.25)%
Operating expenses:			
Claims paid and administration	32,145,463	26,728,106	(16.85)%
Operating expenses - all cost centers	<u>1,528,579</u>	<u>1,283,248</u>	<u>(16.05)%</u>
Total operating expenses	<u>33,674,042</u>	<u>28,011,354</u>	<u>(16.82)%</u>
Operating excess (deficiency) of revenues over expenditures	18,032	(131,728)	(830.52)%
Non-operating - Investment income	<u>-</u>	<u>160,646</u>	<u>DIV/0</u>
Excess of revenues over expenditures	<u>\$ 18,032</u>	<u>\$ 28,918</u>	<u>60.37 %</u>

In 2010, we budgeted revenue in excess of expenses by \$18,032. Investment income was not budgeted in an effort to budget for operations only. In 2009, \$102,000 was budgeted for investment income. The actual operating loss of \$131,728 is \$149,760 below the budgeted operating income. Premium revenues and administrative fees were below budget. Claims paid and health insurance administration expenses were also below expectations. Since the premium and administration fee revenue calculations are based on specific plans and rate structures, changes between plans directly impact these figures. Investment income resulted in a gain of \$160,646 versus budget, which includes unrealized gains on investments totaling \$85,930.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Outlook / Economic Factors

2010 was a tough year for the Trust from a claims perspective. Claims were much higher than projected, driven, to a great degree, by large claims. The adverse claims experience led to a rate increase of 17.56% for 2011.

The Trust continued to promote its innovative "Leader" program in 2010. The program benchmarks members' health and wellness activities and gives them an opportunity to receive a monetary award for improving their benchmark score and maintaining it at a high level. The Trust continued the health lifestyles rewards program that returns money directly to subscribers who complete health assessments and participate in other health and wellness programs. These financial incentives recognize that individuals who make a concerted effort to be better educated health care consumers, and member municipalities that support healthy life and work environments will, over time, save money. In 2010, the Trust returned approximately \$276,000 to members and subscribers.

During calendar year 2011, the Trust staff will continue to work to promote a culture of wellness by encouraging member municipalities, their employees and their dependents to lead healthier lifestyles and to be wise health care consumers. In addition to our efforts, our health insurance partner, CIGNA, has excellent out-reach programs and on-line tools through their website to help subscribers better manage their health and health care. While we understand that improved healthy behavior may not immediately show up as a dollar savings to the Trust's members, it is imperative that we continue to encourage people to do things that we know will have a positive impact on their overall health and on the cost of the health system in the long run.

The 2011 rate increase resulted in substantial changes in the makeup of the Trust. During the 2011 renewal, 13.8% of our member municipalities left the Trust representing 18.7% of subscribers. In addition, the movement of subscribers to lower premium high deductible health plans continued for 2011. Currently 70% of the Trust's subscribers are in high deductible plans, an increase from 50% in 2010 and 3% in 2007.

The Trust Board of Directors ("the Board") voted to provide a new value added service in 2011 to members for no additional premium. Health Advocate is a telephonic support service for subscribers, dependents and select extended family members that assists in problem solving many health care benefit, service and claim issues.

As a result of the challenging 2011 renewal, the Trust Board decided to do a thorough review of the Trust business model. This includes determining where the Trust adds value for members and to determine areas for improvement. The Board is also considering the impact of federal and state level health reform initiatives on its members and is determining how the Trust can help members navigate the multitude of changes that will be occurring over the next few years. The likely outcome of this review is a new look to the Trust for 2012.

VLCT Health Trust, Inc.

Management's Discussion and Analysis (Continued)

Requests for Information

For additional information, please contact the Chief Financial and Administrative 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 Assets

	As of December 31,	
	<u>2010</u>	<u>2009</u>
Assets		
Cash and cash equivalents	\$ 1,424,493	\$ 2,595,840
Mutual funds, at fair value	431,539	368,960
Fixed-maturity securities, at fair value	1,409,588	1,282,389
Working fund deposit	61,677	139,596
Accrued investment income	14,684	14,218
Accounts receivable	10,028	61,352
Amounts due from related entities	107,054	31,648
Health insurance administration receivable	710,280	-
Prepaid expenses	<u>13,711</u>	<u>8,541</u>
 Total Assets	 <u>\$ 4,183,054</u>	 <u>\$ 4,502,544</u>
 Liabilities and Net Assets		
Liabilities		
Unearned income	\$ 883,340	\$ 988,498
Claims payable	327,102	293,015
Accounts payable and accrued expenses	303,327	56,575
Health insurance administration payable	<u>1,574</u>	<u>525,663</u>
Total liabilities	1,515,343	1,863,751
 Net Assets		
Unrestricted	<u>2,667,711</u>	<u>2,638,793</u>
 Total Liabilities and Net Assets	 <u>\$ 4,183,054</u>	 <u>\$ 4,502,544</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Statements of Revenues, Expenses, and Changes in Net Assets

	Years ended December 31,	
	<u>2010</u>	<u>2009</u>
Operating Revenues		
Health insurance premiums	\$ 26,578,236	\$ 30,217,190
Administration fees - Health	1,046,717	1,194,101
Administration fees - Dental	12,639	12,524
Administration fees - Disability/Life	36,105	42,683
PACIF share of wellness contract	146,256	124,914
Other income	<u>59,673</u>	<u>82,464</u>
Total operating revenues	27,879,626	31,673,876
Operating Expenses		
Claims paid	23,662,504	25,900,524
Health insurance administration	3,065,602	4,544,579
Leader program	276,219	349,905
General and administrative expenses	<u>1,007,029</u>	<u>1,027,967</u>
Total operating expenses	28,011,354	31,822,975
Operating loss	(131,728)	(149,099)
Non-Operating Revenues (Expenses)		
Investment income	64,240	85,226
Investment income - net change in fair value	106,535	159,176
Investment management fees	(3,512)	(3,780)
Investment consulting fees	(2,327)	(2,875)
Investment banking fees	<u>(4,290)</u>	<u>(2,608)</u>
Net non-operating revenue	<u>160,646</u>	<u>235,139</u>
Change in Net Assets	28,918	86,040
Net Assets, Beginning of Year	<u>2,638,793</u>	<u>2,552,753</u>
Net Assets, End of Year	<u>\$ 2,667,711</u>	<u>\$ 2,638,793</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Statements of Cash Flows

	Years ended December 31,	
	<u>2010</u>	<u>2009</u>
Cash Flows from Operating Activities		
Receipts for insurance premiums	\$ 26,473,078	\$ 29,531,393
Receipts for administrative fees and commissions	1,095,461	1,249,308
Other receipts	(533,603)	379,178
Payments for claims	(23,628,417)	(25,387,649)
Payments for healthcare administration	(3,589,691)	(4,018,916)
Payments from the Working Fund Deposit	77,919	(35,552)
Payments for administration	<u>(1,036,496)</u>	<u>(1,364,277)</u>
Net cash (used in) provided by operating activities	(1,141,749)	353,485
Cash Flows from Investing Activities		
Receipts of interest income	63,774	85,662
Investment fees paid	(10,129)	(9,263)
Purchases of investments	(668,991)	(1,265,182)
Proceeds of investments	<u>585,748</u>	<u>1,431,307</u>
Net cash (used in) provided by investing activities	(29,598)	242,524
Net change in cash and cash equivalents	(1,171,347)	596,009
Cash and Cash Equivalents, Beginning of Year	<u>2,595,840</u>	<u>1,999,831</u>
Cash and Cash Equivalents, End of Year	<u>\$ 1,424,493</u>	<u>\$ 2,595,840</u>
Reconciliation of Operating Income to Net Cash (Used In) Provided by Operating Activities		
Operating Income	(131,728)	(149,099)
Changes in assets and liabilities:		
Working fund deposit	77,919	(35,552)
Accounts receivable	51,324	55,632
Amounts due from related entities	(75,406)	115,575
Health insurance administration receivable	(710,280)	219,860
Prepaid expenses	(5,170)	593
Unearned income	(105,158)	(685,797)
Claims payable	34,087	293,015
Accounts payable and accrued expenses	246,752	13,595
Health insurance administration payable	<u>(524,089)</u>	<u>525,663</u>
Net cash (used in) provided by operating activities	<u>\$ (1,141,749)</u>	<u>\$ 353,485</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Notes to the Financial Statements

Years ended December 31, 2010 and 2009

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.

The Trust offers a wide variety of employee benefit programs for Vermont municipalities including health, dental, and vision insurance, short and long-term disability insurance, long term care insurance, and Section 125 flexible spending account and COBRA administration.

Members joining the Trust agree to remain members for a minimum of one year, but may be terminated before that time for non-payment of premiums. If a member leaves the Trust at any point other than the first of the policy year and with 30 days written notice, they will be subject to an exit fee. When a member leaves the Trust, they cannot rejoin for two years. Underwriting and rate-setting policies have been established after consulting with actuaries. As of December 31, 2010 and 2009, the Trust provided health coverage to 224 and 227 members, respectively.

Note B - Summary of Significant Accounting Policies

Basis of Accounting

The accounting policies of the Trust follow U.S. generally accepted accounting principles ("GAAP") applicable to public entity risk pools, as prescribed by the Government Accounting Standards Board ("GASB"). Accordingly, the Trust adheres to all GASB pronouncements. The Trust may also apply other pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Those standards include: Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board opinions and Accounting Research Bulletins of the Committee on Accounting Procedure, all of which are collectively included in the FASB Accounting Standards Codification. 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 May 12, 2011, the date on which these financial statements were available to be issued.

VLCT Health Trust, Inc.

Notes to 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.

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; (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.

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 through a recognized pricing service.

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3*, certain disclosures regarding deposit and investment risks have been provided in Note C.

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. Funds held at Citibank Bank (New England) are represented as the working fund deposit on the statement of net assets.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

The Trust's carrying amount of cash deposits and the bank balance at December 31, 2010 and 2009 were as follows:

	<u>December 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Book</u>	<u>Bank</u>	<u>Book</u>	<u>Bank</u>
	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>
Insured/FDIC	\$ 500,000	\$ 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	924,493	928,289	1,551,099	1,551,099
Unsecured and Uncollateralized	-	-	544,715	645,097
Petty Cash	-	-	26	-
Total	<u>\$ 1,424,493</u>	<u>\$ 1,428,289</u>	<u>\$ 2,595,840</u>	<u>\$ 2,696,196</u>

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. During 2010, the Trust's deposits with People's United Bank became fully collateralized.

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, 2010 and 2009 was \$61,677 and \$139,596, 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 \$327,102 and \$293,015 at December 31, 2010 and 2009, respectively and is recorded as claims payable on the statements of net assets.

Funding Claims Receivable

Under a funding arrangement with CIGNA, the Trust's liability for claims each year is capped at

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

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 2010, claims totaling \$25,982,408 exceeded the Trust's funding of \$23,662,504 by \$2,319,904 which was funded by CIGNA. At December 31, 2010, the remaining amount owed to the Trust from CIGNA was \$710,280 for overpayments made during the year and refunds receivable; these amounts are recorded as health insurance administration receivable on the statement of net assets. Based on this arrangement with CIGNA, any claims incurred in 2010 but reported and paid in 2011 will be charged to the 2011 fund year.

For the year ended 2009, the total funding liability was \$26,426,187 of which \$25,900,524 was paid for claims. An additional \$525,663 was due to CIGNA to meet the requirement of the funding agreement at December 31, 2009.

Unearned Income

Unearned income represents the amounts billed and collected at December 31, 2010 for premiums with a coverage effective date of January 1, 2011 or later.

Accounts Receivable

Accounts receivable as of December 31, 2010 and 2009 consist of billed amounts not yet collected for premiums, 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 2010. Management anticipates no uncollectible accounts and, therefore, has not established an allowance for doubtful accounts.

Accounts Payable

Accounts payable as of December 31, 2010 and 2009 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

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Trust's enterprise fund include fund contributions (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 2009 audited financial statements to conform to the 2010 presentation, which had no effect on net assets or change in net assets.

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.
- *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. Obligations that exceed the limit as of December 31, 2010 and 2009.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note C - Investments (Continued)

- *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, 2010. 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, 2010				Total
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	
U.S. Treasuries	\$ 60,439	\$ 39,339	\$ 59,632	\$ 17,468	\$ 176,878
U.S. Agency MBS	-	-	59,831	-	59,831
Corporate Bonds	98,926	308,073	254,293	473,358	1,134,650
Municipal Bonds	-	-	-	38,229	38,229
Total	<u>\$ 159,365</u>	<u>\$ 347,412</u>	<u>\$ 373,756</u>	<u>\$ 529,055</u>	<u>\$ 1,409,588</u>

The table below outlines the Standard and Poor's (S&P) credit ratings of the Trust's fixed-maturity securities as of December 31, 2010:

	U.S. Treasuries	U.S. Agency MBS	Corporate Bonds	Municipal Bonds	Total
AAA	\$ 176,878	\$ 59,831	\$ 279,403	\$ 5,092	\$ 521,204
AA+	-	-	-	9,852	9,852
AA	-	-	6,669	-	6,669
AA-	-	-	35,589	9,602	45,191
A+	-	-	200,216	9,013	209,229
A	-	-	111,488	-	111,488
A-	-	-	48,303	-	48,303
BBB+	-	-	100,928	-	100,928
BBB	-	-	67,512	-	67,512
Not Rated	-	-	284,542	4,670	289,212
Total	<u>\$ 176,878</u>	<u>\$ 59,831</u>	<u>\$ 1,134,650</u>	<u>\$ 38,229</u>	<u>\$ 1,409,588</u>

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note C - Investments (Continued)

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, 2010:

	<u>Fair Value</u>	<u>Effective Duration</u>
U.S. Treasuries	\$ 176,878	5.48
U.S. Agency MBS	59,831	2.73
Corporate Bonds	1,134,650	5.45
Municipal Bonds	<u>38,229</u>	<u>9.24</u>
Total	<u>\$ 1,409,588</u>	5.45

The average effective duration of the investment portfolio as of December 31, 2010 and 2009, was 5.45 and 5.17 years, respectively.

The following table shows the classifications of the Trust's mutual fund investments as of December 31, 2010 and 2009:

<u>Classification</u>	<u>2010 Fair Value</u>	<u>2009 Fair Value</u>
Large Cap Blend	\$ 78,751	\$ 71,364
Large Cap Growth	66,141	55,272
Large Cap Value	77,066	68,191
Mid Cap Growth	73,954	60,005
Mid Cap Value	66,063	56,105
Small Cap Blend	<u>69,564</u>	<u>58,023</u>
Total	<u>\$ 431,539</u>	<u>\$ 368,960</u>

Net realized gains on the sale of investments were \$20,605 and net change in unrealized gains on investments were \$85,930 for the year ended December 31, 2010. Net realized gains on the sale of investments were \$27,772 and net change in unrealized gains on investments were \$131,404 for the year ended December 31, 2009.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

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, 2010 and 2009, expenses allocated to the Trust were \$683,056 and \$656,625 for administrative services and \$20,828 and \$18,088 was paid for auto usage reimbursement, respectively. For the years ended December 31, 2010 and 2009, budgeted administrative expenses allocated to the Trust were 16.2% and 14.6%, respectively, of total allocable VLCT expenses. The budgeted allocation is adjusted at year end for a true-up to actual VLCT expenses allocable to the Trust. These costs are included as a component of general and administrative expenses on the statement of revenues, expenses and changes in net assets.

Note E - Insurance Contract

Effective January 1, 2008, the Trust entered into a minimum premium insurance contract with CIGNA, covering the Trust's health benefits plan. This agreement provides for a maximum funding requirement and is 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.

VLCT Health Trust, Inc.

Notes to Financial Statements (Continued)

Note E - Contract with Insurer/Fund Balance (Continued)

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 is 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 is limited due to the purchase of the experience protection benefit. Amounts paid for this benefit represented \$623,536 and \$642,649 for 2010 and 2009, respectively.

Pursuant to the CMP, the Trust pays CIGNA monthly the amount necessary to pay for retention (residual, access fee, and experience protection benefit) and supplemental premium. The Trust also funds 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 are less than the bank liability amount, the Trust holds the funds and receives the cash flow benefit. If claim costs are more than the bank liability amount, CIGNA funds the overage.

At the end of each plan year, CIGNA reviews 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. As of December 31, 2010, claims exceeded the Trust's funding by \$2,319,904 and was funded by CIGNA. For the year ending December 31, 2009 claims were less than the funding maximum by \$525,663.

Furthermore, upon termination, CIGNA is liable to pay from its reserves, including supplemental premium, all claims incurred during the plan year but unpaid as of the termination date. The Trust does not have any liability for these run-out claims. As of December 31, 2010 and 2009, the Trust paid CIGNA \$0 and \$635,490, respectively, in supplemental reserve premiums.

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.

Notes to Financial Statements (Continued)

Note F - Subsequent Events

As a result of the challenging 2011 renewal, the Trust decided to do a thorough review of the Trust's current business model. The Trust is also considering the impact of federal and state level health reform initiatives on its members. No decisions have been made with respect to the services that will be provided by the Trust in 2012 and beyond. It is possible that the services and programs offered through the trust could change substantially. However, it is expected that the Trust will continue to provide certain health programs and related services.

VLCT Health Trust, Inc.

Claims Development Information

December 31, 2010

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 contribution 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 assets.
- (3) This line shows the net of each fiscal year's earned contribution 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, 2010

	Fiscal and Policy Year Ended (in thousands of dollars)									
	CIGNA			BC/BS Modified Retrospective						
	CIGNA Minimum Premium	CIGNA Retrospective								
2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	
(1) Gross contributions and investment income	28,051	31,919	28,526	28,116	37,772	35,774	31,832	27,920	22,632	21,720
(2) Less: Reinsurance expenses	624	643	587	499	808	598	466	331	223	161
(3) Net earned premiums and investment income	27,427	31,276	27,939	27,617	36,964	35,177	31,366	27,589	22,409	21,559
(4) Unallocated expenses	3,735	5,289	8,010	4,945	4,923	4,177	3,646	3,107	2,632	2,197
(5) Estimated losses and allocated expenses incurred, net at the end of year:	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408	21,206	18,428
(6) HMO Premiums included in Total Estimated Claims and Expenses	-	-	-	-	2,121	2,163	1,974	2,608	2,792	3,279
(7) Paid (Cumulative) as of:										
End of policy year	23,335	25,607	20,341	21,038	31,404	28,127	24,602	23,293	19,571	16,554
One year later		25,901	20,122	23,240	33,742	30,578	26,890	25,408	21,206	18,428
(8) Reestimated incurred losses and expenses										
End of policy year	23,663	25,901	20,122	23,240	33,742	30,578	26,890	25,408	21,206	18,428
One year later		25,901	20,122	23,240	33,742	30,578	26,890	25,408	21,206	18,428

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Reconciliation of Claim Liabilities

December 31, 2010

	<u>Total</u>	
	<u>2010</u>	<u>2009</u>
Claims payable (receivable) for claims at beginning of year	\$ 293,015	\$ (219,860)
Incurred claims:		
Current year	23,662,504	25,900,524
Prior years	-	-
Total claims incurred	<u>23,662,504</u>	<u>25,900,524</u>
Claim payments:		
Current year	23,335,402	25,607,509
Prior years	<u>293,015</u>	<u>(219,860)</u>
Total claims paid	<u>23,628,417</u>	<u>25,387,649</u>
Claims (receivable) payable at end of year	<u>\$ 327,102</u>	<u>\$ 293,015</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Schedule of Revenues and Expenses Budget to Actual

Year ended December 31, 2010

	<u>Budget</u>	<u>Actual</u>	<u>Variance Over/(Under)</u>
REVENUES			
Health insurance premiums	\$ 32,145,463	\$ 26,578,236	\$ (5,567,227)
Administration fees - Health	1,280,861	1,046,717	(234,144)
Administration fees - Dental	8,500	12,639	4,139
Administration fees - Disability/Life	35,000	36,105	1,105
PACIF share of wellness contract	169,250	146,256	(22,994)
Other income	53,000	59,673	6,673
Trust interest	-	64,240	64,240
Change in fair value	-	106,535	106,535
Total Revenues	<u>33,692,074</u>	<u>28,050,401</u>	<u>(5,641,673)</u>
EXPENSES			
Claims Paid and Health Insurer Administration	32,145,463	26,728,106	(5,417,357)
Administration - Cost Center			
VLCT Administration	288,921	264,269	(24,652)
Audit/Accounting	11,800	24,317	12,517
Legal Services	7,000	1,950	(5,050)
Consulting Services	45,000	27,912	(17,088)
Administration Contracts	42,000	42,015	15
Board of Directors	17,200	11,710	(5,490)
Insurance	8,000	11,174	3,174
Investment Management	4,000	3,512	(488)
Investment Consulting	3,500	2,327	(1,173)
Bank Costs	3,300	4,290	990
Dues/Subscriptions	1,000	2,940	1,940
Travel/Training - Staff	5,000	4,060	(940)
Travel/Training - Board	750	722	(28)
Vehicle Expenses	1,000	1,278	278
Printing	1,000	29	(971)
Promotional	100	-	(100)
Annual Meeting	5,000	2,223	(2,777)
Miscellaneous	100	21	(79)
Total Administration	<u>444,671</u>	<u>404,749</u>	<u>(39,922)</u>
Member Relations - Cost Center			
VLCT Administration	308,558	282,667	(25,891)
Legal Services	750	-	(750)
Dues/Subscriptions	600	200	(400)
Travel/Training - Staff	5,500	5,366	(134)
Member Training	5,000	-	(5,000)
Vehicle Expenses	6,000	14,119	8,119
Printing	2,000	1,862	(138)
Communication	15,000	1,528	(13,472)
Vermont Brokerage Commission Trailer	-	1,919	1,919
Promotional	1,000	1,252	252
Miscellaneous	500	-	(500)
Total Member Relations	<u>344,908</u>	<u>308,913</u>	<u>(35,995)</u>

See accompanying notes to the financial statements.

VLCT Health Trust, Inc.

Schedule of Revenues and Expenses Budget to Actual (Continued)

	<u>Budget</u>	<u>Actual</u>	<u>Variance Over/(Under)</u>
Wellness - Cost Center			
VLCT Administration	149,500	136,120	(13,380)
Consulting Services	1,000	-	(1,000)
Dues/Subscriptions	1,500	405	(1,095)
Travel/Training - Staff	6,000	6,716	716
Member Training	79,500	48,270	(31,230)
Invest EAP	81,000	75,266	(5,734)
Vehicle Expenses	10,000	5,431	(4,569)
CIGNA Grant	50,000	23,406	(26,594)
Printing	10,000	7,882	(2,118)
Leader Program	350,000	276,219	(73,781)
Miscellaneous	500	-	(500)
Total Wellness	<u>739,000</u>	<u>579,715</u>	<u>(159,285)</u>
 Total Expenses	 <u>33,674,042</u>	 <u>28,021,483</u>	 <u>(5,652,559)</u>
 Excess of Revenues over Expenses	 <u>\$ 18,032</u>	 <u>\$ 28,918</u>	 <u>\$ 10,886</u>

See accompanying notes to the financial statements.