

AUDITED FINANCIAL STATEMENTS

Washington State Health Insurance Pool

*Years ended December 31, 2014 and 2013
with Report of Independent Auditors*

Washington State Health Insurance Pool

Audited Financial Statements

Years ended December 31, 2014 and 2013

Contents

| | |
|---|---|
| Report of Independent Auditors | 1 |
| Audited Financial Statements | |
| Balance Sheets | 3 |
| Statements of Operations and Unassigned Surplus | 4 |
| Statements of Cash Flows..... | 5 |
| Notes to Financial Statements | 6 |

Report of Independent Auditors

Board of Directors
Washington State Health Insurance Pool

Report on the Financial Statements

We have audited the accompanying financial statements of Washington State Health Insurance Pool (a nonprofit organization) which comprise the balance sheets as of December 31, 2014 and 2013 and the related statements of operations and unassigned surplus 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or material error.

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 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 the 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 Washington State Health Insurance Pool as of December 31, 2014 and 2013, and the results of their operations and cash flows for the years then ended in accordance with accounting practices prescribed or permitted by the Office of the Insurance Commissioner of the State of Washington and accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2015 on our consideration of Washington State Health Insurance Pool's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Washington State Health Insurance Pool's internal control over financial reporting and compliance.

Peter W. Leachman, Vincent & Kane

February 26, 2015

Washington State Health Insurance Pool

Balance Sheets

| | December 31 | |
|---|----------------------|----------------------|
| | 2014 | 2013 |
| Assets | | |
| Cash and short term investments | \$ 19,667,071 | \$ 32,118,470 |
| Assessments receivable | 706,247 | 4,691,059 |
| Uncollected premiums | 33,188 | 81,323 |
| Federal grant receivable | 587,465 | 71,247 |
| Prepaid expenses | - | 405 |
| Total assets | <u>\$ 20,993,971</u> | <u>\$ 36,962,504</u> |
| Liabilities and unassigned surplus | | |
| Claims unpaid | \$ 5,965,000 | \$ 13,855,000 |
| Unpaid claims adjustment expenses | 297,000 | 444,000 |
| Premiums received in advance | 452,343 | 556,101 |
| Assessments payable | 5,882,015 | 1,436,537 |
| Abandoned claims reserve | 29,947 | 71,819 |
| General expenses due and accrued | 153,230 | 269,285 |
| Total liabilities | <u>12,779,535</u> | <u>16,632,742</u> |
| Unassigned surplus | 8,214,436 | 20,329,762 |
| Total liabilities and unassigned surplus | <u>\$ 20,993,971</u> | <u>\$ 36,962,504</u> |

See accompanying notes and report of independent auditors.

Washington State Health Insurance Pool

Statements of Operations and Unassigned Surplus

| | Years ended December 31 | |
|---|--------------------------------|----------------------|
| | 2014 | 2013 |
| Operating revenues: | | |
| Net premium income | \$ 13,806,921 | \$ 36,594,592 |
| | 13,806,921 | 36,594,592 |
| Operating expenses: | | |
| Hospital and medical benefits | 48,949,094 | 108,940,514 |
| Claim adjustment expenses | 655,136 | 831,885 |
| General and administrative expenses | 2,093,480 | 2,213,453 |
| | 51,697,710 | 111,985,852 |
| Operating loss | (37,890,789) | (75,391,260) |
| Non-operating revenues: | | |
| Investment and other income | 3,023 | 94,733 |
| Federal grant awards | 1,110,440 | 1,300,715 |
| | 1,113,463 | 1,395,448 |
| Loss before assessments | (36,777,326) | (73,995,812) |
| Assessments | 24,662,000 | 84,543,448 |
| Change in unassigned surplus | (12,115,326) | 10,547,636 |
| Unassigned surplus at beginning of year | 20,329,762 | 9,782,126 |
| Unassigned surplus at end of year | \$ 8,214,436 | \$ 20,329,762 |

See accompanying notes and report of independent auditors.

Washington State Health Insurance Pool

Statements of Cash Flows

| | Years ended December 31 | |
|--|--------------------------------|---------------|
| | 2014 | 2013 |
| Operating activities | | |
| Premiums collected | \$ 13,735,113 | \$ 32,683,121 |
| Claims and claims adjustment expenses paid | (57,561,181) | (111,850,514) |
| General administrative expenses paid | (2,314,866) | (3,042,454) |
| Cash used by operating activities | (46,140,934) | (82,209,847) |
| Investing activities | | |
| Investment and other income | 3,023 | 340,235 |
| Cash provided by investing activities | 3,023 | 340,235 |
| Financing activities | | |
| Assessments collected | 53,930,290 | 85,521,061 |
| Assessment paid | (20,838,000) | - |
| Federal grant proceeds | 594,222 | 1,698,722 |
| Cash provided by financing activities | 33,686,512 | 87,219,783 |
| Net increase (decrease) in cash and cash equivalents | (12,451,399) | 5,350,171 |
| Cash and short term investments at beginning of year | 32,118,470 | 26,768,299 |
| Cash and short term investments at end of year | \$ 19,667,071 | \$ 32,118,470 |

See accompanying notes and report of independent auditors.

Washington State Health Insurance Pool

Notes to Financial Statements

December 31, 2014 and 2013

1. Organization and Significant Accounting Policies

Organization

Washington State Health Insurance Pool (the "Pool"), a nonprofit unincorporated entity, was established by the State of Washington to make health care coverage available for eligible persons in Washington who have been rejected for individual coverage by licensed insurance carriers. The Pool has the authority, under state law, to assess insurance companies writing health premiums in the State of Washington for all losses of the Pool. Presently, assessments are made as funds are needed.

Basis of Presentation

The accompanying financial statements have been prepared, except as to form, on the basis of accounting practices prescribed or permitted by the Office of the Insurance Commissioner of the State of Washington. Such practices may vary from accounting principles generally accepted in the United States of America ("GAAP"). However, the effect of such variances is not considered to be material and the financial statements are also considered to be in conformity with GAAP.

Use of Estimates

Preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and 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.

Cash and Cash Equivalents

All investments with a remaining maturity of three months or less at the date of acquisition are considered cash equivalents. Short-term investments are recorded at cost, which approximates market.

Washington State Health Insurance Pool

Notes to Financial Statements (continued)

December 31, 2014 and 2013

1. Organization and Significant Accounting Policies (continued)

Assessments

Assessments of the insurer members are approved by the Board of Directors and are recognized as a contribution to unassigned surplus. Assessments are made periodically and are based on projected cash flow needs. Assessments receivable represents outstanding balances assessed to insurance companies but not yet collected, and assessments payable represents amounts overpaid by insurance companies and are to be refunded.

During 2014 the State of Washington enacted legislation that required WSHIP to partially fund the newly formed Washington Health Benefit Exchange (HBE), in the amount of \$20.8 million, for the purpose of assisting with the transition of WSHIP members to the HBE. The amount was included in assessments to the insurer members and payment was made to the State. The assessment and payment has been included in assessments in the accompanying statements of operations and unassigned surplus.

Unpaid Claims and Related Expenses

The liabilities for unpaid claims and related expenses are estimated based on historical claim development, including the effects of six-month pre-existing condition exclusion. Considerable variability is inherent in such estimates. However, management believes that liabilities for unpaid claims and related expenses are adequate. The estimates are continually reviewed and updated as experience develops or new information becomes known; such adjustments are reflected in current operations.

Premium deficiencies are not recognized as the Pool has the statutory authority to assess member plans for operating losses.

Revenue Recognition

Premiums are earned pro rata over the periods to which the premiums relate. Premiums received in advance represent amounts received in advance of the policy effective date.

Washington State Health Insurance Pool

Notes to Financial Statements (continued)

December 31, 2014 and 2013

1. Organization and Significant Accounting Policies (continued)

Concentration of Credit Risk

Deposits at the Pool's financial institutions are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Pool has not experienced a loss due to uninsured balances, and at December 31, 2014 and 2013, none of the Pool's deposits are uninsured.

Income Taxes

The Internal Revenue Service has determined that the Pool qualifies as a tax-exempt organization under Section 501(c)(26) of the Internal Revenue Code ("IRC") and is, therefore, not subject to tax under present income tax law. The Pool is required to operate in conformity with the IRC to maintain its qualification. The Pool is also exempt from State of Washington taxes.

In consideration of Accounting Standards Codification ("ASC") 740-10-25 *Income Taxes*, the Pool has not taken any uncertain tax positions that should be recognized in the accompanying financial statements. The Pool's 2013, 2012 and 2011 tax returns are subject to examination by the Internal Revenue Service.

Regulatory Examination

The Pool's financial statements are subject to examination by the Office of the Insurance Commissioner of the State of Washington ("OIC"). Such examinations could result in adjustments to the Pool's financial statements. The OIC's most recent examination covers the years 2008 through 2012, and was completed during 2014. No findings were noted that would require an adjustment to the financial statements.

Washington State Health Insurance Pool

Notes to Financial Statements (continued)

December 31, 2014 and 2013

1. Organization and Significant Accounting Policies (continued)

Pre-Existing Condition Insurance Pool

The Pool is the single member of the Pre-Existing Condition Insurance Pool – WA, LLC (“PCIP”), formed in 2010 to administer the U. S. Department of Health and Human Services’ (“HHS”) temporary health insurance program to individuals residing in the State of Washington who previously have been uninsured. HHS reimburses PCIP for claims paid in excess of premiums received, and for administrative expenses. HHS has made funds available to all states for similar health insurance programs, and initially allocated \$101,612,997 to PCIP.

WSHIP allocates certain personnel and other operating costs to PCIP; allocations totaled \$126,991 and \$292,110 for 2014 and 2013, respectively; no amounts are due to WSHIP from PCIP at December 31, 2014 or 2013.

Effective June 30, 2013, the administration of PCIP was transitioned to the federal government, and PCIP was dissolved effective December 31, 2014. PCIP will process run-out claims for an additional eighteen months; claims that were incurred on or prior to June 30, 2013 and are timely reported will be paid in accordance with the policy provisions.

2. Federal Grant

During 2014 and 2013, the Department of Health and Human Services awarded the Pool a High Risk Pool Grant to be used to fund operating losses of the Pool, and Bonus Grant funds to be used to reduce premiums to insureds and implement a disease management program. The grant funds have been reported as non-operating revenue in the accompanying statements of operations and unassigned surplus.

| | Years ended December 31 | |
|------------------|-------------------------|---------------------|
| | 2014 | 2013 |
| Operations Grant | \$ 522,975 | \$ 835,225 |
| Bonus Grant | 587,465 | 465,490 |
| | <u>\$ 1,110,440</u> | <u>\$ 1,300,715</u> |

Washington State Health Insurance Pool

Notes to Financial Statements (continued)

December 31, 2014 and 2013

3. Plan Administration Agreement

The Pool has outsourced its administrative services to Benefit Management Inc., a Kansas based third party administrator, under a service agreement effective through December 2015. In accordance with the agreement, the Pool is charged a monthly per-member-per-month fee based on the number of active members, and variable fees for certain services. Total fees paid to Benefit Management Inc. in 2014 and 2013 were \$964,594 and \$1,472,018, respectively, and are included in general and administrative expenses in the accompanying statements of operations and unassigned surplus.

4. Liability for Unpaid Claims

The following table provides a reconciliation of the beginning and ending balances of the liability for unpaid claims and unpaid claims adjustment expenses:

| | Years ended December 31 | |
|--------------------------------------|-------------------------|---------------|
| | 2014 | 2013 |
| Balances at January 1 | \$ 14,299,000 | \$ 17,209,000 |
| Policy benefits incurred related to: | | |
| Current year | 50,842,149 | 114,379,922 |
| Prior years (redundancy) | (1,893,055) | (5,439,408) |
| Total policy benefits incurred | 48,949,094 | 108,940,514 |
| Paid related to: | | |
| Current year | 44,605,706 | 100,129,922 |
| Prior years | 12,380,388 | 11,720,592 |
| Total paid | 56,986,094 | 111,850,514 |
| Balances at December 31 | \$ 6,262,000 | \$ 14,299,000 |

Policy benefits incurred related to prior years varies from previously estimated liabilities as the claims are ultimately settled. The changes in amounts incurred related to prior years are the result of changes in morbidity experience, health care utilization and claim payment patterns.

Washington State Health Insurance Pool
Notes to Financial Statements (continued)

December 31, 2014 and 2013

5. Line of Credit

The Pool has a secured revolving line of credit agreement with KeyBank National Association, which provides for borrowing up to a maximum of \$5 million. There were no outstanding balances at December 31, 2014 or 2013, nor were there any borrowings against this line during 2014 or 2013.

6. Subsequent Events

In accordance with ASC 855 *Subsequent Events*, the Pool has evaluated subsequent events through February 26, 2015, the date these financial statements were available to be issued. There were no material subsequent events that required recognition or additional disclosure in these financial statements.