



Pinnacol Assurance Health and Welfare Trust

Financial Statements

December 31, 2016 and 2015

(With Independent Auditor's Report and
Compilation Report Thereon)

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PINNACOL ASSURANCE HEALTH AND WELFARE TRUST MANAGEMENT DISCUSSION AND ANALYSIS

This discussion and analysis, which is prepared in conformity with Governmental Accounting Standards Board (GASB) rules, is designed to provide an analysis of Pinnacol Assurance Health and Welfare Trust's (the Trust) financial condition and operating results. According to GASB rules, the intent of the management discussion and analysis is to inform the readers of the financial statements of the Trust's financial issues and activities.

The Management Discussion and Analysis (MD&A) should be read in conjunction with the Trust's basic financial statements and the Trust's basic financial statements should be read in conjunction with the MD&A.

The Trust's basic financial statements are the Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

Trust Overview:

The Trust was formed on January 1, 2010. The purpose of the Trust is to provide medical, dental, vision and prescription drug benefits to the employees of Pinnacol Assurance. Pinnacol Assurance is a political subdivision of the State of Colorado, exempt from federal income tax under Internal Revenue Code of 1986, as amended. The trust was formed as an essential governmental function and integral part of the exempt activities of Pinnacol Assurance within the meaning of section 115 of the Internal Revenue Code. The Trust has no ERISA compliance requirements and it is not regulated by the Division of Insurance of the State of Colorado. At December 31, 2016 and 2015 there were 678 and 644 individuals covered by the Trust, respectively.

The Trust contracts with Kaiser Permanente (Kaiser), United HealthCare (UHC), and Delta Dental (Delta) to provide medical and prescription drug benefits. Under this arrangement, the Trust reimburses Kaiser, UHC and Delta for all healthcare claims. The Trust also contracts with VSP for vision benefits. The Trust also offers its participants a flexible spending account and contracts with WageWorks to administer this program. The Trust engages a third party broker to assist in administration of the benefit programs.

Overview of Financial Statements:

Basic Financial Statements are presented on the accrual basis of accounting. The three basic statements presented within the financial statements are as follows:

Statements of Net Position -- These statements present information reflecting the net position, which represents the amount of total assets less total liabilities. Although the statement of net position is not presented in a categorized basis, assets are nonetheless listed in liquid to non-liquid order. Liquidity in this reference means cash or ability to be turned into cash.

The Statements of Revenues, Expenses and Changes in Net Position -- These statements reflect the Trust's operating revenues and expenses. The essential source of revenues is from contributions from Pinnacol Assurance and from covered individuals. The major sources of operating expenses are health, dental, and vision benefits. The change in net position is similar to net profit for any other insurance entity.

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MANAGEMENT DISCUSSION AND ANALYSIS**

The Statements of Cash Flows -- These statements reflect the Trust's cash flows from operating and investing activities.

The following summarizes the Basic Financial Statements and provides variance explanations for significant variances for the years ended December 31, 2015 and 2016:

Statements of Net Position

	<u>2016</u>	<u>2015</u>	<u>Change</u>
Assets			
Cash	\$ 1,273,023	\$ 1,885,948	\$ (612,925)
Restricted cash	144,000	144,000	-
Accounts receivable	3,995	622,403	(618,408)
Total Assets	<u>\$ 1,421,018</u>	<u>\$ 2,652,351</u>	<u>\$ (1,231,333)</u>
Liabilities			
Claims reserves	\$ 676,392	\$ 832,935	\$ (156,543)
Claims payable	96,389	168,983	(72,594)
Employee flexible spending payable	41,125	26,973	14,152
Accounts payable & accrued expenses	193,187	154,725	38,462
Total liabilities	<u>1,007,093</u>	<u>1,183,616</u>	<u>(176,523)</u>
Total net position (unrestricted)	<u>413,925</u>	<u>1,468,735</u>	<u>\$ (1,054,810)</u>

The change column illustrates that net position decreased overall in 2016. The primary driver was increased medical claim payments compared to 2015 while contributions did not increase substantially in the same period. Cash decreased by 32% as a result. Accounts receivable, which represent benefit contributions receivable, decreased due to a change in timing of payroll deductions in December 2015 and 2016.

Claims reserves decreased despite an increase in claims expenses and payments in 2016. This is because of a change in methodology to determine the IBNR. The 2016 IBNR was based on a 36 month lag report of claims paid. In prior years, the IBNR was based on 1.5 months of claims paid. The change in methodology to determine the IBNR provides a more accurate reflection of the lag related to reserves. Claims payable represent the outstanding claims the Trust owes at year-end, which can fluctuate depending on the timing of the claims. Employee flexible spending payable increased due to increased participants and fluctuation in the payment timing to WageWorks. Accounts payable and accrued expenses represent liabilities to vendors for administrative expenses.

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Statements of Revenues, Expenses and Changes in Net Position

	<u>2016</u>	<u>2015</u>	<u>Change</u>
Operating revenue:			
Contributions	\$ 7,916,241	\$ 7,416,924	\$ 499,317
Miscellaneous income	189	9,047	(8,858)
Total operating revenue	<u>7,916,430</u>	<u>7,425,971</u>	<u>490,459</u>
Operating expenses:			
Net claims incurred	7,146,199	5,245,117	1,901,082
Insurance premiums	99,745	92,779	6,966
Administration	<u>1,725,296</u>	<u>1,662,273</u>	<u>63,023</u>
Total operating expenses	<u>8,971,240</u>	<u>7,000,169</u>	<u>1,971,071</u>
Operating income (loss)	(1,054,810)	425,802	(1,480,612)
Increase (Decrease) in net position	(1,054,810)	425,802	(1,480,612)
Net position - Beginning of year	<u>1,468,735</u>	<u>1,042,933</u>	<u>425,801</u>
Net position - End of year	<u>\$ 413,925</u>	<u>\$ 1,468,735</u>	<u>\$ (1,054,810)</u>

The changes in the contributions from 2015 to 2016 reflects the increase in participants and increased cost arising from medical inflation and the Affordable HealthCare Act.

The change in the overall costs of claims is a reflection of the increased number of individuals covered by the Trust, as well as an unusually high volume of significant claims in 2016. Claims related to UHC increased by 35% and Kaiser claims increased by 47% over 2015. The Trust has entered into stop-loss insurance contracts to limit large losses. The stop-loss coverage limits the Trust's exposure to \$125,000 for UHC claims paid per person and \$100,000 for Kaiser claims paid per person for 2015 and 2016.

Insurance premiums, which are the premiums owed to VSP for vision benefits increased slightly due to increased participants.

Administration costs increased from 2015 to 2016 primarily due to the increase in administration fees by UHC. There was also an increase in administrative costs for the stop-loss reinsurance program and Affordable HealthCare Act fees.

Economic Conditions & Outlook:

In 2016, health care cost trends continued to accelerate at rates higher than inflation. The "Affordable HealthCare Act" passed by the U.S. Congress in 2010 continues to impact estimated costs for 2016. It is currently unknown whether the change in the federal administration in 2017 will have an impact on future costs. The utilization component of drug trends continues to be higher for generic drugs than for brand drugs.

Based on the above projections and historical results, corporations are continuing to make adjustments in health care plans to cope with the increasing cost trends. Some of these adjustments include increasing co-pays, higher deductibles, and switching providers searching

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for lower cost options. An alternative approach is utilization management. This focuses on the employee and helps them live a healthier lifestyle and be wiser health care consumers. Education and wellness programs are the key component of this strategy.

The Trust and Pinnacol Assurance continue to put health care consumerism to the test with wellness and health education programs aimed at improving outcomes, thereby lowering health care costs. Pinnacol Assurance educates and incentivizes employees to be as engaged as possible, and gives them the tools and to make them knowledgeable about their condition and about their prevention and treatment alternatives, so they make the best decision on health care access and utilization, improve their outcomes and help keep cost in check. Communication with employees has increased to be on a continuous basis not just during policy renewal time. Input is solicited from employees regarding plan design changes, benefit design changes, and contribution adjustments. Communication includes continuous publications introducing all the tools and resources available to assist the employees to become better health care purchasers.

Requests for Information

This report is designed to provide a general overview of the Trust's finances and operations. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Kathy Kranz at 303-361-4864 or Barbara Brannen at 303-361-4961.



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Independent Auditor's Report

The Trustees
Pinnacol Assurance Health and Welfare Trust

We have audited the accompanying financial statements of Pinnacol Assurance Health and Welfare Trust, which comprise the statement of net position as of December, 31, 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 Pinnacol Assurance Health and Welfare Trust as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have compiled the 2015 financial statements of Pinnacol Assurance Health and Welfare Trust. Management is responsible for the accompanying financial statements, which comprise the statement of net position as of December



31, 2015, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. We have performed the compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. Management's Discussion and Analysis is presented as supplementary information required by the Governmental Accounting Standards Board and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

K Financial

Louisville, CO
April 20, 2017

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST

STATEMENTS OF NET POSITION

DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and cash equivalents	\$ 1,273,023	\$ 1,885,948
Restricted cash	144,000	144,000
Accounts receivable	3,995	622,403
TOTAL ASSETS	<u>\$ 1,421,018</u>	<u>\$ 2,652,351</u>
LIABILITIES AND NET POSITION		
LIABILITIES		
Claim reserves	\$ 676,392	\$ 832,935
Claims payable	96,389	168,983
Employee flexible spending payable	41,125	26,973
Accounts payable and accrued expenses	193,187	154,725
TOTAL LIABILITIES	<u>1,007,093</u>	<u>1,183,616</u>
NET POSITION		
Unrestricted	<u>413,925</u>	<u>1,468,735</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 1,421,018</u>	<u>\$ 2,652,351</u>

The accompanying notes are an integral part of the financial statements.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
OPERATING REVENUE		
Contributions	\$ 7,916,241	\$ 7,416,924
Miscellaneous income	<u>189</u>	<u>9,047</u>
Total operating revenue	<u>7,916,430</u>	<u>7,425,971</u>
OPERATING EXPENSES		
Claims, net of stop loss recoveries of \$ 375,597 and \$ 302,968 in 2016 and 2015, respectively	7,146,199	5,245,117
Insurance premiums	99,745	92,779
Administration	<u>1,725,296</u>	<u>1,662,273</u>
Total operating expenses	<u>8,971,240</u>	<u>7,000,169</u>
OPERATING INCOME (LOSS)	(1,054,810)	425,802
INCREASE (DECREASE) IN NET POSITION	(1,054,810)	425,802
NET POSITION - BEGINNING OF YEAR	<u>1,468,735</u>	<u>1,042,933</u>
NET POSITION - END OF YEAR	<u>\$ 413,925</u>	<u>\$ 1,468,735</u>

The accompanying notes are an integral part of the financial statements.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST

STATEMENTS OF CASH FLOWS

DECEMBER 31, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Contributions received from members	\$ 8,534,649	\$ 7,395,318
Claims paid	(7,375,335)	(5,320,947)
Payments paid to insurers	(99,745)	(92,779)
Employee flexible spending available	14,152	(8,289)
Administrative expenses paid	(1,686,835)	(1,551,872)
Miscellaneous income received, net	<u>189</u>	<u>9,047</u>
Net cash provided by (used in) operating activities	(612,925)	430,478
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(612,925)	430,478
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>1,885,948</u>	<u>1,455,470</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,273,023</u>	<u>\$ 1,885,948</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income (loss)	(1,054,810)	425,802
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Effects of changes in operating assets and liabilities:		
Accounts receivable	618,409	(21,606)
Claims payable	(72,594)	40,484
Claims reserves	(156,543)	(116,314)
Employee flexible spending payable	14,152	(8,289)
Administration fees payable	<u>38,461</u>	<u>110,401</u>
Net cash provided by (used in) operating activities	<u>\$ (612,925)</u>	<u>\$ 430,478</u>

The accompanying notes are an integral part of the financial statements.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 1: ORGANIZATION

Pinnacol Assurance Health and Welfare Trust (the Trust) was formed on January 1, 2010. The purpose of the Trust is to provide medical, dental, vision and prescription drug benefits to the employees of Pinnacol Assurance. At December 31, 2016 and 2015 there were approximately 678 and 644 individuals, respectively, covered by the Trust. The Trust collects contributions from Pinnacol Assurance and covered employees and makes payments for benefits, insurance premiums, stop loss coverage and administrative fees.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to governmental risk pools, set forth by the Governmental Accounting Standards Board. The accrual basis of accounting is utilized where revenue is recognized when earned and expenses are recognized when the liability is incurred.

The Trust distinguishes between operating revenues and expenses and non-operating items in the Statement of Revenues, Expenses and Changes in Net Position. Operating revenues and expenses generally result from providing services in connection with the Trust's purpose of providing medical, dental and vision insurance coverage for Pinnacol Assurance employees. Operating revenues consist of contributions from Pinnacol Assurance and from covered employees. Operating expenses include the cost of claims paid, administrative expenses, insurance premiums to carriers and stop loss fees. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The Trust has elected to follow Governmental Accounting Standards Board pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reserve for Claims Payable

Claims are charged to operations as incurred and are reported net of stop loss recoveries. The liability for claims payable is determined based upon case-basis evaluations and projections and includes a provision for incurred but not reported claims. The projections of ultimate losses on reported claims and the estimate of claims incurred but not reported are based on a composite of the Trust's experience, trends in costs of services and changes in the number of covered employees. Adjustments to the probable ultimate liability for claims are made continually based on subsequent developments and experience and are included in operations as incurred (see Note 6).

Contributions

The Trust collects contributions from Pinnacol Assurance and covered employees. Contributions are determined by a flat rate. The Trust engages a third party that works directly with the carriers to determine the flat rate for the employees on an annual basis. The employer flat rate is determined by calculating the difference between projected claims for the year and employee contributions.

Administration Costs

The Trust pays administration fees to Kaiser Permanente (Kaiser), United Healthcare (UHC), and Delta Dental to administer claims. Administration fees include: fixed and variable fees. The fixed fees are based on a set rate for a minimum number of enrolled employees and multiplied by the actual volume on a monthly basis. Variable fees are calculated monthly at a percentage of the sum of the allowed amounts of medical claims.

Income Tax

The Trust is qualified and exempt from income tax under the provisions of Section 115 of the Internal Revenue Code. Therefore, the accompanying financial statements do not include a provision for income taxes.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 3: CASH

At December 31, 2016, the Trust's cash deposits had a bank balance of \$1,316,810 of which \$250,000 is insured by the Federal Deposit Insurance Corporation (FDIC). The carrying balance of cash deposits as of December 31, 2016 was \$1,273,023.

At December 31, 2015, the Trust's cash deposits had a bank balance of \$1,886,421 of which \$250,000 is insured by the Federal Deposit Insurance Corporation (FDIC). The carrying balance of cash deposits as of December 31, 2015 was \$1,885,948.

NOTE 4: STOP-LOSS INSURANCE CONTRACTS

The Trust has entered into stop-loss insurance contracts to limit large losses. The stop-loss coverage limits the Trust's exposure to \$125,000 for UHC claims paid per person and \$100,000 for Kaiser claims paid per person in 2016 and 2015.

Although management believes they have acquired stop-loss insurance from solvent carriers, a contingent liability exists with respect to insurance coverages which would become a liability of the Trust if the stop-loss insurers were unable to meet their obligations under the contracts.

NOTE 5: ADMINISTRATIVE AND CLAIMS SERVICING AGREEMENTS

The Trust contracts with Kaiser, UHC, and Delta Dental to provide medical and prescriptions drug benefits. Under these agreements the Trust reimburses Kaiser, UHC, and Delta Dental for all healthcare claims. The Trust also purchases insurance from VSP for vision benefits. The Trust also offers its participants a flexible spending account option and contracts with WageWorks to administer this program. The Trust engages a third party broker to assist in the administration of these benefit programs.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 6: CLAIM RESERVES AND CLAIMS PAYABLE

As discussed in Note 2, the Trust establishes a liability for both reported and un-reported claims. The following represents changes in that liability for the Trust during the years ended December 31, 2016 and 2015.

	<u>2016</u>	<u>2015</u>
Claim reserves and claims payable, beginning of year	\$1,001,918	\$ 1,077,748
Provision for claims expenses		
Provision for covered events of the current year	7,297,562	5,905,702
Decrease in provision for covered events of prior years	<u>(151,363)</u>	<u>(660,585)</u>
	<u>7,146,199</u>	<u>5,245,117</u>
Payments, net of stop-loss recoveries		
Claims expenses attributable to covered events of the current year	6,524,781	4,903,784
Claims expenses attributable to covered events of prior years	<u>850,555</u>	<u>417,163</u>
Total payments	<u>7,375,336</u>	<u>5,320,947</u>
Claim reserves and claims payable, end of year	<u>\$772,781</u>	<u>\$1,001,918</u>

As a result of changes in estimates of insured events in prior years, the provision for claims expenses decreased by \$151,363 and \$660,585 in 2016 and 2015, respectively. The decreases in 2016 and 2015 are due to lower than expected losses pertaining to prior years.

NOTE 7: SUBSEQUENT EVENTS

The Trust has evaluated events subsequent to December 31, 2016 through April 20, 2017, which is the issuance date of this report. There were no material events noted in the subsequent period that would have impacted the results reported herein or in the Trust's results going forward.