



Pinnacol Assurance Health and Welfare Trust

Financial Statements

December 31, 2017 and 2016

(With Independent Auditor's 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, 2017 and 2016 there were 665 and 678 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.

**PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
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, 2016 and 2017:

Statements of Net Position

	<u>2017</u>	<u>2016</u>	<u>Change</u>
Assets			
Cash	\$ 1,543,006	\$ 1,273,023	\$ 269,983
Restricted cash	190,000	144,000	46,000
Accounts receivable	0	3,995	(3,995)
Prepaid expense	<u>53,086</u>	<u>0</u>	<u>53,086</u>
Total Assets	<u>\$ 1,786,092</u>	<u>\$ 1,421,018</u>	<u>\$ 365,074</u>
Liabilities			
Claims reserves	\$ 640,086	\$ 676,392	\$ (36,306)
Claims payable	158,387	96,389	61,998
Employee flexible spending payable	54,106	41,125	12,981
Accounts payable & accrued expenses	<u>118,910</u>	<u>193,187</u>	<u>(74,277)</u>
Total liabilities	<u>971,489</u>	<u>1,007,093</u>	<u>(35,604)</u>
Total net position (unrestricted)	<u>814,603</u>	<u>413,925</u>	<u>\$ 400,678</u>

The change column illustrates that net position increased overall in 2017. The primary driver was medical claim payments normalized compared to 2016 while contributions increased in the same period. Cash increased by 21% as a result. Accounts receivable, which represent benefit contributions receivable, decreased due to 2018 COBRA payments received and deposited in 2017. The prepaid expense at December 31, 2017 represents a \$53k invoice paid in advance for January 2018 UHC Admin fees.

Claims reserves decreased due to lower Kaiser claims in 2017 and the run off of the self-funded benefit plan for this provider. In 2018 Kaiser will transition from a self-funded benefit plan to a fully-funded benefit plan. The 2017 IBNR is based on a 36 month lag report of claims paid. Claims payable represent the outstanding claims the Trust owes at year-end, which can fluctuate depending on the timing of the claims. The increase primarily represents an increase in Kaiser claims accrual and outstanding checks at the end of the year. 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. In 2017 the Affordable Care Act transitional reinsurance program ended which decreased the accrued expense in 2017. As mentioned above Kaiser will transition to a fully-funded benefit plan which decreased the 2017 claims admin runoff.

**PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
MANAGEMENT DISCUSSION AND ANALYSIS**

Statements of Revenues, Expenses and Changes in Net Position

	<u>2017</u>	<u>2016</u>	<u>Change</u>
Operating revenue:			
Contributions	\$ 9,797,765	\$ 7,916,241	\$ 1,881,524
Miscellaneous income	<u>67,232</u>	<u>189</u>	<u>67,043</u>
Total operating revenue	<u>9,864,997</u>	<u>7,916,430</u>	<u>1,948,567</u>
Operating expenses:			
Net claims incurred	7,652,381	7,146,199	506,182
Insurance premiums	111,416	99,745	11,671
Administration	<u>1,700,522</u>	<u>1,725,296</u>	<u>(24,775)</u>
Total operating expenses	<u>9,464,319</u>	<u>8,971,240</u>	<u>493,078</u>
Operating income (loss)	400,678	(1,054,810)	1,455,489
Increase (Decrease) in net position	400,678	(1,054,810)	1,455,489
Net position - Beginning of year	<u>413,925</u>	<u>1,468,735</u>	<u>(1,054,810)</u>
Net position - End of year	<u>\$ 814,603</u>	<u>\$ 413,925</u>	<u>\$ 400,679</u>

The changes in the contributions from 2016 to 2017 are related to the increase in employee and employer contributions due to increased cost arising from medical inflation and the Affordable HealthCare Act.

The change in the overall costs of claims is a reflection of rising medical costs. Claims related to UHC increased by 27% and Kaiser claims decreased by 17% over 2016. 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 2016 and 2017.

Insurance premiums, which are the premiums owed to VSP for vision benefits increased slightly due to an increase in rates by 11.7% from 2016 to 2017.

Administration costs increased by 2.7% from 2016 to 2017 primarily due to the increase in administration fees by UHC.

Economic Conditions & Outlook:

The increasing cost of health insurance continues to be employer's greatest concern specific to managing their benefits program. Employers have ranked this as their top concern for the previous 13 years. Additional top concerns were a) regulatory compliance (particularly federal reporting requirements), and b) employee satisfaction related to benefits that affect recruiting and retention. To stay aligned with these increases, employers reported deploying numerous tactics including increasing the employee and family contributions, increasing deductibles, increasing employee out-of-pocket expense for prescription drugs, reducing benefits and/or changing carriers. They are also using more targeted strategies to attack healthcare cost drivers through pharmacy management, using more efficient provider networks, and implementing consumerism tools (e.g. cost transparency).

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST MANAGEMENT DISCUSSION AND ANALYSIS

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 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 to make them knowledgeable about their condition and about their prevention and treatment alternatives, so they make the best decisions 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.

Pinnacol moved from a self-funded arrangement to a fully insured arrangement with Kaiser in 2018 for several reasons: Pinnacol was one of the few self-funded plans with Kaiser in Colorado, and the majority of Kaiser resources are devoted to fully insured plans; Kaiser used a third party claims adjudicator, Harrington Health, and Pinnacol employees did not receive the level of service that was expected by Pinnacol for claims; Pinnacol is expected to see a cost savings of over \$1 million from moving to a fully-insured arrangement. Pinnacol will continue to monitor trends in the market and make necessary plan changes accordingly.

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 statements of net position as of December, 31, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matter

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. Management's Discussion and Analysis 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.

K Financial

Louisville, Colorado
April 20, 2018

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST

STATEMENTS OF NET POSITION

DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and cash equivalents	\$ 1,543,006	\$ 1,273,023
Restricted cash	190,000	144,000
Accounts receivable	-	3,995
Prepaid expense	53,086	-
TOTAL ASSETS	<u>\$ 1,786,092</u>	<u>\$ 1,421,018</u>
LIABILITIES AND NET POSITION		
LIABILITIES		
Claim reserves	\$ 640,086	\$ 676,392
Claims payable	158,387	96,389
Employee flexible spending payable	54,106	41,125
Accounts payable and accrued expenses	<u>118,910</u>	<u>193,187</u>
TOTAL LIABILITIES	<u>971,489</u>	<u>1,007,093</u>
NET POSITION		
Unrestricted	<u>814,603</u>	<u>413,925</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 1,786,092</u>	<u>\$ 1,421,018</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, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
OPERATING REVENUE		
Contributions	\$ 9,797,765	\$ 7,916,241
Miscellaneous income	<u>67,232</u>	<u>189</u>
Total operating revenue	<u>9,864,997</u>	<u>7,916,430</u>
OPERATING EXPENSES		
Claims, net of stop loss recoveries of \$ 183,320 and \$ 375,597 in 2017 and 2016, respectively	7,652,381	7,146,199
Insurance premiums	111,416	99,745
Administration	<u>1,700,522</u>	<u>1,725,296</u>
Total operating expenses	<u>9,464,319</u>	<u>8,971,240</u>
OPERATING INCOME (LOSS)	400,678	(1,054,810)
INCREASE (DECREASE) IN NET POSITION	400,678	(1,054,810)
NET POSITION - BEGINNING OF YEAR	<u>413,925</u>	<u>1,468,735</u>
NET POSITION - END OF YEAR	<u>\$ 814,603</u>	<u>\$ 413,925</u>

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

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST

STATEMENTS OF CASH FLOWS

DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Contributions received	\$ 9,801,760	\$ 8,534,649
Claims paid	(7,626,689)	(7,375,335)
Payments paid to insurers	(111,416)	(99,745)
Employee flexible spending available	12,981	14,152
Administrative expenses paid	(1,829,390)	(1,686,835)
Accounts payable	1,505	-
Miscellaneous income received	67,232	189
Increase in restricted cash	<u>(46,000)</u>	<u>-</u>
Net cash provided by (used in) operating activities	269,983	(612,925)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	269,983	(612,925)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>1,273,023</u>	<u>1,885,948</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,543,007</u>	<u>\$ 1,273,023</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income (loss)	400,678	(1,054,810)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Effects of changes in operating assets and liabilities:		
Restricted cash	(46,000)	-
Accounts receivable	3,995	618,409
Prepaid expense	(53,086)	-
Claims payable	61,998	(72,594)
Claims reserves	(36,306)	(156,543)
Employee flexible spending payable	12,981	14,152
Accounts payable and accrued expenses	<u>(74,277)</u>	<u>38,461</u>
Net cash provided by (used in) operating activities	<u>\$ 269,983</u>	<u>\$ (612,925)</u>

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

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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, 2017 and 2016 there were approximately 665 and 678 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, 2017 AND 2016

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, 2017 AND 2016

NOTE 3: CASH

At December 31, 2017, the Trust's cash deposits had a bank balance of \$1,631,333 of which \$250,000 is insured by the Federal Deposit Insurance Corporation (FDIC). The carrying balance of cash deposits as of December 31, 2017 was \$1,543,006.

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.

Bank balances up to \$250,000 are insured by the Federal Deposit Insurance Corporation. Remaining balances exceeding \$250,000 fall under the provisions of the Public Deposit Protection Act.

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 2017 and 2016.

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 prescription 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.

NOTE 6: RELATED PARTY TRANSACTIONS

Pinnacol Assurance contributed approximately \$7.7 million and \$6.2 million to the Trust during the years ended December 31, 2017 and 2016, respectively. Employees of Pinnacol Assurance contributed \$2.0 million and \$1.7 million to the Trust during the years ended December 31, 2017 and 2016, respectively.

PINNACOL ASSURANCE HEALTH AND WELFARE TRUST
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

NOTE 7: 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, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
Claim reserves and claims payable, beginning of year	\$772,781	\$ 1,001,918
Provision for claims expenses		
Provision for covered events of the current year	7,994,957	7,297,562
Decrease in provision for covered events of prior years	<u>(342,576)</u>	<u>(151,363)</u>
	<u>7,652,381</u>	<u>7,146,199</u>
Payments, net of stop-loss recoveries		
Claims expenses attributable to covered events of the current year	7,196,483	6,524,781
Claims expenses attributable to covered events of prior years	<u>430,206</u>	<u>850,555</u>
Total payments	7,626,689	7,375,336
Claim reserves and claims payable, end of year	<u>\$798,473</u>	<u>\$772,781</u>

As a result of changes in estimates of insured events in prior years, the provision for claims expenses decreased by \$342,576 and \$151,363 in 2017 and 2016, respectively. The decreases in 2017 and 2016 are due to lower than expected losses pertaining to prior years.

NOTE 8: SUBSEQUENT EVENTS

The Trust has evaluated events subsequent to December 31, 2017 through April 20, 2018, which is the issuance date of this report. The Trust transitioned from a self-funded arrangement to a fully insured arrangement with Kaiser in January 2018. This change has no impact on the Trust's 2017 financial statements, but is expected to lead to a reduction in contributions and expenses in 2018. There were no other material events noted in the subsequent period that would have impacted the results reported herein or in the Trust's results going forward.