

# **The Health Pool of South Dakota**

Financial Report (Reviewed)

June 30, 2011



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## Independent Accountant's Report

To the Board of Trustees  
The Health Pool of South Dakota  
Pierre, South Dakota

We have reviewed the accompanying basic financial statements of The Health Pool of South Dakota (the Pool), as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. A review includes primarily applying analytical procedures to management's financial data and making inquiries of Pool management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Our reviews were made for the purpose of expressing limited assurance that there are no material modifications that should be made to the basic financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. The Schedule of Claims Development Information on page 10 as required by the Governmental Accounting Standards Board is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the inquiry and analytical procedures applied in the reviews of the basic financial statements and we did not become aware of any material modifications that should be made to such information. Management has chosen not to present a Management's Discussion and Analysis for the Pool that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements.

*McGladrey & Pullen, LLP*

Sioux Falls, South Dakota  
October 14, 2011

**The Health Pool of South Dakota**

**Statements of Net Assets  
June 30, 2011 and 2010  
See Accountant's Report**

<b>Assets</b>	<b>2011</b>	<b>2010</b>
Current Assets		
Cash and cash equivalents (Note 2)	\$ 1,052,213	\$ 1,183,772
Certificates of deposit (Note 2)	2,008,128	1,961,067
Receivables:		
Reinsurance (Notes 3 and 4)	18,718	24,115
Investment income	7,362	24,649
<b>Total current assets</b>	<b>3,086,421</b>	<b>3,193,603</b>
Certificates of deposit (Note 2)	<b>200,000</b>	-
	<b>\$ 3,286,421</b>	<b>\$ 3,193,603</b>
<b>Liabilities and Net Assets</b>		
Current Liabilities		
Estimated liability for reported and unreported claims and claims adjustment expenses (Notes 3 and 4)	\$ 275,000	\$ 275,000
Net Assets		
Unrestricted	<b>3,011,421</b>	2,918,603
	<b>\$ 3,286,421</b>	<b>\$ 3,193,603</b>

See Notes to Financial Statements.

The Health Pool of South Dakota

Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended June 30, 2011 and 2010

See Accountant's Report

	2011	2010
Operating revenues:		
Member contributions earned (Note 7)	\$ 2,131,119	\$ 2,141,343
Less: Reinsurance premiums ceded (Note 4)	193,669	146,607
<b>Net operating revenues</b>	<b>1,937,450</b>	<b>1,994,736</b>
Operating expenses:		
Claims and claims adjustment expenses incurred (Notes 3, 4 and 5):		
Claims incurred	1,716,278	1,538,524
Claims adjustment expenses incurred	52,483	54,364
<b>Total claims and claims adjustment expenses incurred</b>	<b>1,768,761</b>	<b>1,592,888</b>
General and administrative expenses:		
Ancillary services expense (Note 5)	36,003	36,491
Accounting and bookkeeping fees	21,875	5,517
Actuary fees	14,000	-
Sponsorship fee (Note 6)	10,300	10,000
Service fee (Note 6)	9,692	9,409
Board of Trustee fees and expenses	3,317	4,387
Bonds and insurance	2,426	2,310
Advertising	2,219	2,319
Administrative fees (Note 5)	-	20,405
Other	2,527	2,151
<b>Total general and administrative expenses</b>	<b>102,359</b>	<b>92,989</b>
<b>Operating income</b>	<b>66,330</b>	<b>308,859</b>
Nonoperating revenues:		
Investment income (Note 2)	26,488	51,432
Other	-	6,493
<b>Total nonoperating revenues</b>	<b>26,488</b>	<b>57,925</b>
<b>Change in net assets</b>	<b>92,818</b>	<b>366,784</b>
Net assets:		
Beginning of year	2,918,603	2,551,819
End of year	<b>\$ 3,011,421</b>	<b>\$ 2,918,603</b>

See Notes to Financial Statements.

**The Health Pool of South Dakota**

**Statements of Cash Flows**

**Years Ended June 30, 2011 and 2010**

**See Accountant's Report**

	<b>2011</b>	<b>2010</b>
<b>Cash Flows From Operating Activities</b>		
Contributions received	\$ 2,131,119	\$ 2,141,343
Reinsurance premiums paid	(193,669)	(146,607)
Underwriting and expenses of operations paid	(98,608)	(92,905)
Claims and claims adjustment expenses paid	(1,763,364)	(1,492,003)
<b>Net cash provided by operating activities</b>	<b>75,478</b>	<b>409,828</b>
<b>Cash Flows From Investing Activities</b>		
Purchases of certificates of deposit	(2,208,128)	(1,761,067)
Maturities of certificates of deposit	1,961,067	1,050,000
Investment income received	40,024	55,982
Other	-	6,493
<b>Net cash used in investing activities</b>	<b>(207,037)</b>	<b>(648,592)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(131,559)</b>	<b>(238,764)</b>
<b>Cash and Cash Equivalents</b>		
Beginning	1,183,772	1,422,536
Ending	<b>\$ 1,052,213</b>	<b>\$ 1,183,772</b>
<b>Reconciliation of Operating Income to Net Cash Provided By Operating Activities</b>		
Operating income	\$ 66,330	\$ 308,859
Change in assets and liabilities:		
(Increase) decrease in receivables	9,148	(24,031)
Increase in estimated liability for reported and unreported claims and claims adjustment expenses	-	125,000
<b>Net cash provided by operating activities</b>	<b>\$ 75,478</b>	<b>\$ 409,828</b>

See Notes to Financial Statements.



## The Health Pool of South Dakota

### Notes to Financial Statements

#### See Accountant's Report

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#### Note 1. Nature of Business and Significant Accounting Policies

**Reporting entity:** The Health Pool of South Dakota (Pool) provides health and other health related coverages for member organizations. There were 36 members of the Pool as of both June 30, 2011 and 2010, all of which were cities, counties, townships and special districts of the State of South Dakota. The objective of the Pool is to provide and implement group health coverage and health maintenance cost containment programs and procedures to employees of South Dakota public agencies. The Pool is supervised by the Board of Trustees consisting of up to seven members.

The Pool operates as a single proprietary fund, more specifically as an enterprise fund. The Pool distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Pool's principal ongoing operations. Nonoperating revenues and expenses generally result from investment activities.

The Pool is exposed to various risks of loss related to torts and errors and omissions. The Pool has purchased commercial insurance to mitigate its risks.

The Pool's by-laws contain a provision stating that if a series of claims exhaust the Pool's net assets, then the payment of those claims will be the sole and separate obligation of the individual member or members against whom the claim is made and perfected by litigation or settlement. Members agree to continue membership in the Pool for a period of not less than twelve months from a renewal date of July 1, and may withdraw from the Pool by giving written notice to the Pool no later than thirty days prior to July 1. All claims and claim expenses paid after the date of withdrawal become the sole responsibility of the withdrawing member without regard to whether the claims occurred or were reported prior to the member's withdrawal from the Pool. The Pool assumes no liability for payment of claims by virtue of servicing claims for members that terminate or withdraw from the Pool. At the request of the withdrawing member, the Pool will continue to service all claims which had been reported to the Pool during the withdrawing member's period of participation, so long as the withdrawing member promptly repays the Pool for all claims and claim expenses incurred.

No Pool surplus amounts have been allocated to individual members through June 30, 2011. Any amounts included in a withdrawing member's equity account will be refunded to the member in five equal annual installments beginning one calendar year following withdrawal. Members expelled from the Pool for violation of conditions set forth in the by-laws forfeit any right of return of contribution, including interest in their member's equity account.

A summary of the Pool's significant accounting policies follows:

**Basis of presentation:** The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The Pool prepares its financial statements primarily following the guidance of Governmental Accounting Standards Board (GASB) Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" (as amended by subsequent GASB statements) along with other applicable standards issued by the GASB as well as applicable standards issued by the Financial Accounting Standards Board (FASB) previously issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements. GASB Statement No. 10 establishes accounting and financial reporting standards for risk financing and insurance-related activities of public entity risk pools.

## The Health Pool of South Dakota

### Notes to Financial Statements See Accountant's Report

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#### Note 1. Nature of Business and Significant Accounting Policies (continued)

**Use of estimates:** The preparation of financial statements 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. A material estimate that is particularly susceptible to significant change in the near-term relates to the estimated liability for reported and unreported claims and claims adjustment expenses.

**Cash and cash equivalents:** For purposes of reporting cash flows, the Pool considers money market funds to be cash equivalents. Cash and cash equivalents as of June 30, 2011 and 2010 include approximately \$610,000 and \$1,179,000, respectively, in money market funds. The Pool believes it is not exposed to any significant credit risk on cash and cash equivalents. Certificates of deposit are considered investments as all have been purchased with maturities in excess of ninety days.

**Receivables:** Receivables are recorded based on amounts billed to members and other third party payers, and amounts estimated to be received or recovered from reinsurers and other third party payers. The Pool evaluates the collectability of such receivables monthly based on the third party payers' financial condition, credit history, and current economic conditions. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

**Investments:** Certificates of deposits are stated at cost. Interest income is recognized when earned.

**Member contributions and unearned income:** Members are billed on the 1<sup>st</sup> of the month during the month in which coverage begins. Income from such contributions is recorded as earned during the coverage period. Contributions received in advance for coverage in the following policy year are recorded as unearned member contributions. Member contributions are reduced by reinsurance premiums ceded to the reinsurance companies.

**Premium deficiency:** A premium deficiency exists when the sum of expected claims costs (including an estimated liability for unreported claims), all expected claims adjustment expenses, and policy acquisition costs exceed related unearned premiums. The Pool anticipates investment income in determining if a premium deficiency exists.

**Reinsurance:** In the normal course of business, the Pool and its members seek to reduce the loss that may arise from events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Amounts recoverable from the reinsurers under excess of loss coverages are estimated in a manner consistent with the development of the estimated liability for reported and unreported claims and claims adjustment expenses.

**Income taxes:** The Pool's income is excludable from income tax under section 115 of the Internal Revenue Code. A private letter ruling on the Pool's tax exempt status has not been requested.

## The Health Pool of South Dakota

### Notes to Financial Statements

#### See Accountant's Report

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#### **Note 1. Nature of Business and Significant Accounting Policies (continued)**

**Estimated liability for reported and unreported claims and claims adjustment expenses:** The coverage offered by the Pool is on an occurrence basis which provides for payment of claims that occur during the period of coverage and which are submitted within twelve months of the date of occurrence. The estimated liability for reported and unreported claims and claims adjustment expenses is based upon data developed by the Pool's Administrator. The liability includes estimates of the costs to settle individual claims which have been reported, plus a provision for claims incurred but not yet reported. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Claims are reduced for subrogation when payment is received, as subrogation amounts are immaterial.

As adjustments to this estimated liability become necessary, such adjustments are reflected in current operations. Management of the Pool believes the estimated liability for unreported claims and claims adjustment expenses is sufficient to cover the ultimate net cost of incurred claims, but such reserves are necessarily based on estimates and the ultimate liability may be greater or less than the amounts estimated. The Pool has not engaged an actuary to assist in the estimating process which may result in abnormal volatility in such liabilities.

#### **Note 2. Deposits and Investments**

**Custodial credit risk:** The Pool's cash and cash equivalents are comprised of money market and deposit accounts. Custodial credit risk is the risk that in the event of a bank failure, the Pool's deposits may not be returned to it. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (i.e. broker-dealer) to a transaction, the Pool will not be able to recover the value of its investments that are in the possession of another party. The Pool seeks to reduce credit risk by having qualified public depositories furnish collateral in the sum equal to one hundred percent (100%) of the public deposit accounts that exceed deposit insurance. As of June 30, 2011 and 2010, none of the Pool's bank balance was exposed to custodial credit risk as uninsured and uncollateralized, as collateral was pledged by the financial institution in the financial institution's name, not the Pool's name, for the amounts. The Pool's money market funds are not rated.

**Interest rate risk:** The Pool limits interest rate risk by structuring the portfolio to meet the cash requirements of ongoing operations, thereby mitigating the need to liquidate securities at a loss prior to maturity. Investment maturities are staggered in such a manner that all investments will not come due at the same time. Unless matched with specific cash flow, the Pool will not directly invest in securities maturing more than 24 months from the date of purchase. At least 10% of the investable funds shall be accessible for use by the Pool in a one day notice.

## The Health Pool of South Dakota

### Notes to Financial Statements

#### See Accountant's Report

#### Note 2. Deposits and Investments (continued)

**Credit risk:** The Pool's approved investment policy states that all investments shall be federally insured, protected against loss as provided in SDCL 4-6A-9 as "public deposits" in qualified public depositories, or meet the requirements of SDCL 4-5-6. Suitable investments include interest bearing checking accounts, savings accounts, United States Treasury bills, bonds and notes, United States Government Agencies, securities of the United States and securities guaranteed by the US Government either directly or indirectly including, without limitation, United States Treasury bills, notes, bonds and other obligations issued or directly or indirectly guaranteed by the US Government, or otherwise directly or indirectly backed by the full faith and credit of the US Government; provided that, for other than permanent, trust, retirement, building, and depreciation reserve funds, such securities shall either mature within eighteen months from the date of purchase or be redeemable at the option of the holder within eighteen months of the date of purchase, certificates of deposit, certificates of deposit purchased through CDARS®, money market mutual funds - open-end, no-load, mutual and money market funds that invest in US Treasury securities or federally related institutions that are guaranteed directly or indirectly by the US Government, and repurchase agreements fully collateralized by allowable securities. The Pool has no investment policy that would further limit its investment choices other than as described in its investment footnote disclosures.

**Concentration of credit risk:** The Pool's investment policy states that no more than 50% of the investable funds shall be placed in any one financial institution.

#### Note 3. Estimated Liability for Reported and Unreported Claims and Claims Adjustment Expenses

The Pool establishes liabilities for both reported and unreported covered events, which includes estimates of both future payments of claims and related claims adjustment expenses. The following is a summary of the changes in those aggregate liabilities for the fiscal years ended June 30, 2011, 2010 and 2009.

	2011	2010	2009
Reported and unreported claims and claims expenses at beginning of year	\$ 275,000	\$ 150,000	\$ 200,000
Incurred claims and claims adjustment expenses:			
Provision for insured events of the current year	1,897,650	1,617,086	1,355,971
Provision for insured events of prior years	(128,889)	(24,198)	(121,616)
Total incurred claims and claims adjustment	1,768,761	1,592,888	1,234,355
Payments:			
Claims and claims adjustment expenses attributable to insured events of the current year	1,643,176	1,366,201	1,205,971
Claims and claims adjustment expenses attributable to insured events of prior years	120,188	125,802	78,384
Total payments	1,763,364	1,492,003	1,284,355
Less reinsurance recoverables at beginning of year	(24,115)	-	-
Plus reinsurance recoverables at end of year	18,718	24,115	-
Total reported and unreported claims and claims adjustment expenses at end of year	\$ 275,000	\$ 275,000	\$ 150,000

## The Health Pool of South Dakota

### Notes to Financial Statements

#### See Accountant's Report

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#### **Note 3. Estimated Liability for Reported and Unreported Claims and Claims Adjustment Expenses (continued)**

The 2011, 2010 and 2009 decreases in the prior year provision of incurred claims and claims adjustment expenses resulted from positive loss development experience as more information became known and payments made.

#### **Note 4. Reinsurance**

The Pool and its members utilize reinsurance agreements to limit maximum loss and minimize exposures on larger risks. Under the reinsurance agreements in effect during fiscal years 2011 and 2010, the Pool was reimbursed under an individual stop loss policy.

Under the fiscal year 2011 and 2010 stop loss policies, each covered member is subject to a \$75,000 deductible with a maximum individual lifetime stop loss reimbursement of \$2,000,000.

The Pool and its members would be liable for any obligations that the reinsurance companies are unable to meet under the reinsurance agreements. During fiscal years 2011 and 2010, the Pool received \$371,637 and \$523,255, respectively, of recoveries from the reinsurance company under contract.

#### **Note 5. Service Agreements**

The Pool has an agreement with First Administrators, Inc. (FAI) to provide claims and program administration for the Pool. The agreement expired June 30, 2011 and automatically renews for a one year term unless terminated by either party within thirty days notice. The contracted compensation rate was \$18.50 and \$17.95 per covered employee per month for claims administration during fiscal years 2011 and 2010, respectively. Fees incurred under this agreement for the fiscal years ended June 30, 2011 and 2010 were \$52,483 and \$54,364, respectively.

FAI has contracted with various companies to provide ancillary services such as utilization review and access to preferred provider discounts. The Pool collects premiums from the respective members and pays for third party service fees (included in ancillary services expense in the accompanying statements of revenues and expenses).

The Pool had an agreement with Hagan Benefits, Inc. (HBI) to provide accounting services for the Pool. The agreement between HBI and the Pool expired on June 30, 2010 and was not renewed. Fees incurred under this agreement for the fiscal year ended June 30, 2010 were \$20,405.

#### **Note 6. Related Party Transactions**

The South Dakota Municipal League (SDML) is the sponsoring organization of the Pool. The Pool paid SDML \$10,300 and \$10,000 during fiscal years 2011 and 2010, respectively, as a sponsorship fee and \$9,692 and \$9,409 during 2011 and 2010, respectively, as a service fee. No amounts were due to or from SDML at June 30, 2011 and 2010.

#### **Note 7. Major Members**

The Pool had three major members in 2011 and 2010. A major member is one which provides 10% or more of an entity's revenue in any year. Net member contributions earned from the "major" members were approximately \$745,000, \$264,000 and \$250,000 for the fiscal year ended 2011 and \$669,000, \$264,000 and \$259,000 for the fiscal year ended 2010, respectively. No amounts were due from the "major" members at June 30, 2011 or 2010.

The Health Pool of South Dakota

Required Supplementary Information - Schedule of Claims Development Information

For the Ten Years Ended June 30, 2011

See Accountant's Report

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net earned member contributions and investment income:										
Earned	\$ 1,410,519	\$ 1,622,836	\$ 1,764,138	\$ 2,156,873	\$ 2,465,677	\$ 2,581,806	\$ 2,508,677	\$ 2,144,417	\$ 2,192,775	\$ 2,157,607
Ceded	130,128	164,433	175,868	175,930	176,181	195,946	154,669	135,484	146,607	193,669
<b>Net earned</b>	<b>1,280,391</b>	<b>1,458,403</b>	<b>1,588,270</b>	<b>1,980,943</b>	<b>2,289,496</b>	<b>2,385,860</b>	<b>2,354,008</b>	<b>2,008,933</b>	<b>2,046,168</b>	<b>1,963,938</b>
Unallocated expenses	59,073	61,295	88,050	89,522	102,564	105,659	98,861	91,420	92,989	102,359
Estimated claims and expenses, end of policy year:										
Incurred	1,270,848	1,064,795	2,004,097	2,022,546	1,558,897	2,456,821	1,612,546	1,355,971	2,140,341	2,269,287
Ceded	-	-	105,037	53,617	-	134,276	-	-	523,255	371,637
<b>Net incurred</b>	<b>1,270,848</b>	<b>1,064,795</b>	<b>1,899,060</b>	<b>1,968,929</b>	<b>1,558,897</b>	<b>2,322,545</b>	<b>1,612,546</b>	<b>1,355,971</b>	<b>1,617,086</b>	<b>1,897,650</b>
Net paid (cumulative) as of:										
End of policy year	1,195,848	934,795	1,656,930	1,812,875	1,308,897	2,052,842	1,412,546	1,205,971	1,366,201	1,643,176
One year later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512	1,490,930	1,331,773	1,486,389	
Two years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512	1,490,930	1,331,773		
Three years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512	1,490,930			
Four years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512				
Five years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407					
Six years later	1,312,905	1,112,306	1,778,804	1,862,701						
Seven years later	1,312,905	1,112,306	1,778,804							
Eight years later	1,312,905	1,112,306								
Nine years later	1,312,905									
Reestimated ceded claims and expenses	-	-	105,037	53,617	-	134,276	-	-	523,255	371,637
Reestimated net incurred claims and expenses:										
End of policy year	1,270,848	1,064,795	1,899,060	1,968,929	1,558,897	2,322,545	1,612,546	1,335,971	1,617,086	1,897,650
One year later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512	1,490,930	1,311,773	1,488,197	
Two years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512	1,490,930			
Three years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407	2,212,512				
Four years later	1,312,905	1,112,306	1,778,804	1,862,701	1,573,407					
Five years later	1,312,905	1,112,306	1,778,804	1,862,701						
Six years later	1,312,905	1,112,306	1,778,804							
Seven years later	1,312,905	1,112,306								
Eight years later	1,312,905									
Nine years later										
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	42,057	47,511	(120,256)	(106,228)	14,510	(110,033)	(121,616)	(24,198)	(128,889)	-