

North Carolina Bar Association Health Benefit Trust

Audited Financial Statements

*Years ended September 30, 2012 and 2011  
with Report of Independent Auditors*

North Carolina Bar Association Health Benefit Trust

Audited Financial Statements

Years ended September 30, 2012 and 2011

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## Report of Independent Auditors

Board of Trustees  
North Carolina Bar Association Health Benefit Trust

We have audited the accompanying Statements of Benefit Obligations and Net Assets Available for Plan Benefits of the North Carolina Bar Association Health Benefit Trust ("the Trust") as of September 30, 2012 and 2011 and the related Statements of Changes in Benefit Obligations and Net Assets Available for Plan Benefits for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the North Carolina Bar Association Health Benefit Trust as of September 30, 2012 and 2011 and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplemental schedule of assets held for investment purposes as of September 30, 2012 is presented for purposes of additional analysis and is not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. Such information is the responsibility of the Trust's 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 audit 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.



Raleigh, North Carolina  
January 14, 2013

## North Carolina Bar Association Health Benefit Trust

### Statements of Benefit Obligations and Net Assets Available for Plan Benefits

	As of September 30,	
	2012	2011
<b>Benefit obligations</b>		
Health claims liability	\$ 2,599,932	\$ 1,422,355
<b>Assets</b>		
Receivables:		
Employer contributions receivable	90,419	56,654
Reinsurance recoverable	232,281	139,547
Collected contributions due from third-party administrator	804,699	924,024
Pharmacy rebates receivable	176,578	251,440
Accrued interest and dividends	21,841	20,937
Total receivables	1,325,818	1,392,602
Cash and cash equivalents	7,396,737	3,824,816
Short-term investments	2,805,642	1,988,707
Investments	8,861,742	8,678,514
Prepaid expenses	9,832	12,034
Total assets	20,399,771	15,896,673
<b>Liabilities</b>		
Advanced contributions	1,140,221	1,441,242
Payable for securities	499,500	-
Accounts payable	502,992	406,440
Total liabilities	2,142,713	1,847,682
Net assets available for plan benefits	18,257,058	14,048,991
Excess of net assets available for plan benefits over benefit obligations	\$ 15,657,126	\$ 12,626,636

*See accompanying notes to the financial statements.*

## North Carolina Bar Association Health Benefit Trust

### Statements of Changes in Benefit Obligations and Net Assets Available for Plan Benefits

	<u>Years ended</u>	<u>September 30,</u>
	<u>2012</u>	<u>2011</u>
<b>Net change in benefit obligations</b>		
Net change during the year attributable to:		
Health claims payable	<u>\$ 1,177,577</u>	<u>\$ (604,033)</u>
<b>Net change in net assets available for plan benefits</b>		
<b>Additions</b>		
Employer contributions	31,604,574	31,703,901
Pharmacy rebates earned	401,161	621,476
Net investment income earned	125,699	146,165
Net realized gains	10,803	12,660
Change in fair value of investments	<u>37,699</u>	<u>(15,250)</u>
Total additions	<u>32,179,936</u>	<u>32,468,952</u>
<b>Deductions</b>		
Participant benefits	23,693,294	26,984,369
General expenses	<u>4,278,575</u>	<u>3,952,471</u>
Total deductions	<u>27,971,869</u>	<u>30,936,840</u>
Net change in net assets available for plan benefits	<u>4,208,067</u>	<u>1,532,112</u>
Excess of net change in net assets available for plan benefits over the change in benefit obligations	3,030,490	2,136,145
Excess of net assets available for plan benefits over benefit obligations at beginning of year	<u>12,626,636</u>	<u>10,490,491</u>
Excess of net assets available for plan benefits over benefit obligations at end of year	<u>\$ 15,657,126</u>	<u>\$ 12,626,636</u>

*See accompanying notes to the financial statements.*

# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements

Years ended September 30, 2012 and 2011

### Note A - Organization and Significant Accounting Policies

#### *Organization*

The North Carolina Bar Association Health Benefit Trust ("the Trust") is a North Carolina domiciled multiple employer welfare arrangement ("MEWA"), which was granted a Certificate of Authority, effective October 1, 2002, under North Carolina General Statute §58-49-30. The Trust is sponsored by the North Carolina Bar Association ("the Sponsor") and is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Trust is also subject to regulation by the North Carolina Department of Insurance ("NCDOI").

The Trust is a health and benefit program whereby an employee of a participating employer, upon employment, may elect coverage. Contributions to the Trust are made by participating employers for amounts determined by the Trust. Benefits and administrative expenses are paid by the Trust from contributions made by participating employers.

The Trust has contracted with various third parties to provide management and administrative services. These arrangements are summarized as follows:

<b>Party</b>	<b>Services provided</b>	<b>Fee</b>
Lawyers Insurance Agency ("LIA")	Accounting and financial reporting, treasury and cash management, marketing, consulting and advisory, and staffing pursuant to a Service Agreement	Service fee based on the number of covered employees per month
BCBS of North Carolina	Premium billing and collections, claims adjudication and processing, benefit payments and reporting, and provider network services pursuant to an Administrative Services Agreement	Administrative fee based on the number of covered employees per month

# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements (Continued)

### Note A - Organization and Significant Accounting Policies (continued)

#### Organization (continued)

<u>Party</u>	<u>Services provided</u>	<u>Fee</u>
GHB Consulting, Inc.	Actuarial and limited underwriting services pursuant to a Service Contract	Administrative fee based on the number of covered employees per month
Scott Benefit Services	Regulatory compliance, advisory and third-party provider liaison, pursuant to a Management Services Agreement	Administrative fee based on the number of covered employees per month

#### Basis of Reporting

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") promulgated by the Financial Accounting Standards Board Accounting Standards Codification ("ASC" or "the guidance"). The preparation of financial statements in accordance with GAAP 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.

#### Termination Provisions

Although it has not expressed any intent to do so, the Sponsor has the right to terminate the Trust by written instrument delivered to the Trustees. Upon such termination, the Trust shall be paid out by the Trustees in accordance with the underlying Trust agreement.

#### Receivables

The Trust routinely assesses the collectibility of amounts due from third parties. The Trust has determined that no allowance is necessary at September 30, 2012 and 2011.

#### Cash and Short-term Investments

Cash and cash equivalents as of September 30, 2012 and 2011 consist of highly liquid investments with original maturities of three months or less when purchased. Short-term investments consist of investments with original maturities of one year or less when purchased. Included in these accounts are amounts exceeding FDIC insured limits.

# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements (Continued)

### **Note A - Organization and Significant Accounting Policies (continued)**

#### *Investments*

Current GAAP guidance establishes a three-level hierarchy that prioritizes inputs to valuation techniques used to measure fair value of invested assets. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), the next priority to quoted prices for identical assets and liabilities in inactive markets or similar assets and liabilities in active markets (Level 2), and the lowest priority to unobservable inputs (Level 3).

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The Trust's fixed maturity securities are classified as available-for-sale and are reported at their estimated fair value based on average bid prices of identical or similar issues with the same life and expected yields (Level 2). Security transactions are recognized on the trade date (the date the order to buy or sell is executed). Gains and losses are determined using the specific identification basis.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term. Such changes could materially affect the amounts reported in the statement of benefit obligations and net assets available for plan benefits.

#### *Accounts payable*

As of September 30, 2012 and 2011, a significant component of accounts payable represents amounts due to BCBS of North Carolina for claims administration fees associated with the Trust's unpaid health claims liability. Such fees due amounted to \$275,000 as of September 30, 2012 and 2011.

#### *Income Tax Status*

The Trust is exempt from federal income taxes under Section 501(c)(9) of the Internal Revenue Code, however, the Trust is required to pay federal and state income taxes on unrelated business income. During 2012, the Trust amended tax returns from 2009 to 2011, resulting in unrelated business income tax expense of approximately \$292,000 which is included in general expenses on the Statements of Changes in Benefit Obligations and Net Assets Available for Plan Benefits. For the current year, the unrelated business income tax expense was approximately \$46,000 and is included in general expenses on the Statements of Changes in Benefit Obligations and Net Assets Available for Plan Benefits. The Trust operates as a self-funded MEWA, solely and exclusively as a non-profit entity for the purpose of providing benefits to employees of



# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements (Continued)

### **Note A - Organization and Significant Accounting Policies (continued)**

#### *Income Tax Status (continued)*

participating employers. The Trust is required to file Form 990, *Return of Organization Exempt From Income Tax*.

The Sponsor analyzed the tax positions taken by the Trust, and concluded that as of September 30, 2012 and 2011, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. No tax planning strategies were used during the years ended September 30, 2012 and 2011. Tax returns filed within the past three years are subject to examination by the Internal Revenue Service. There are no examinations currently being conducted.

#### *Contributions*

Contributions are earned when due. Contributions received for future periods are included as advanced contributions. Contributions earned are reported net of amounts ceded to reinsurers.

#### *Health claims liability*

The health claims liability reported in the financial statements consists of two primary components: amounts for projected losses incurred but not yet reported ("IBNR"), calculated based upon claims projections utilizing certain assumptions and industry data and is net of reinsurance recoverable; claims paid by BCBS of North Carolina that have not yet been funded by the Trust. Although considerable variability is inherent in IBNR estimates, management believes that the health claims liability reported as of September 30, 2012 and 2011 represents the best estimate of the ultimate net cost of settling unpaid health claims incurred through September 30, 2012 and 2011. However, because of future events beyond the control of management, actual loss experience may not conform to the assumptions used in determining the estimated amounts for such reserves at the balance sheet date. Accordingly, the ultimate liability could be significantly in excess of or less than the amount indicated in the financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

#### *Reinsurance*

As described more fully in Note C, the Trust entered into reinsurance agreements, whereby the Trust cedes to reinsurers portions of covered losses. Management believes that reinsurance recoverables on paid claims, as recorded, represents its best estimate of such amounts and has determined that no allowance is necessary as of September 30, 2012 and 2011. Reinsurance recoverables on unpaid claims have been estimated using assumptions consistent with those used in establishing the gross health claims liability, and are reported as a component of reinsurance recoverable in the statements of benefit obligations and net assets available for benefits. Reinsurance contracts do not relieve the Trust of its primary obligation to insureds.

# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements (Continued)

### **Note A - Organization and Significant Accounting Policies (continued)**

#### *Pharmacy Rebates*

Pharmacy rebates receivable represent management's best estimate of amounts due to the Trust based on pharmacy expenses incurred during the reporting period. Such estimates have been established based upon the historical experience of the Trust. Pharmacy rebates received during the years ended September 30, 2012 and 2011 were \$476,023 and \$501,360, respectively.

#### *Subsequent Events*

The Trust has evaluated subsequent events for disclosure and recognition through January 14, 2013, the date on which these financial statements were available to be issued, and considered any relevant matters in the preparation of the financial statements.

### **Note B - Investments**

The fair values of individual investments that represent 5% or more of the Trust's total net assets available for benefits are as follows at September 30:

	2012	2011
Short-term investments:		
Dreyfus Government Cash Management	\$ 2,805,642	\$ 1,988,707
Total	\$ 2,805,642	\$ 1,988,707

The major components of the net change in fair value of investments, and interest on investments, during the year ended September 30, 2012 were as follows:

	Net change in fair value of investments	Interest income	Total
Cash and short-term investments	\$ -	\$ 10,523	\$ 10,523
U.S. Government agencies	741	83,380	84,121
Mortgage-backed securities	36,958	31,796	68,754
Total	\$ 37,699	\$ 125,699	\$ 163,398

## North Carolina Bar Association Health Benefit Trust

### Notes to Financial Statements (Continued)

#### **Note B - Investments (continued)**

The major components of the net change in fair value of investments, and interest on investments, during the year ended September 30, 2011 were as follows:

	Net change in fair value of investments	Interest income	Total
Cash and short-term investments	\$ -	\$ 3,363	\$ 3,363
U.S. Government agencies	(37,536)	134,425	96,889
Mortgage-backed securities	22,286	8,377	30,663
Total	\$ (15,250)	\$ 146,165	\$ 130,915

#### **Note C - Reinsurance**

For the year ended September 30, 2012, the Trust purchased specific and aggregate excess of loss reinsurance from AIG Life Insurance Company with an effective date of October 1, 2011 and an expiration date of September 30, 2012. The specific excess of loss coverage has an attachment point of \$175,000, per individual, and a limit of liability of \$4,825,000 in excess of the attachment point, per individual; however, the Trust is not eligible for recoveries against claims paid until the aggregate amount for all individual claims that have exceeded the individual attachment point have surpassed an additional \$100,000 deductible. The aggregate excess of loss coverage (applicable to aggregate claims paid during the reinsurance term) has a minimum attachment point of \$41,976,374 and a limit of liability of \$1,000,000 in excess of the attachment point. Contributions and health claims ceded to the reinsurer during the year ended September 30, 2012 amounted to \$1,165,402 and \$232,278, respectively.

For the year ended September 30, 2011, the Trust purchased specific and aggregate excess of loss reinsurance from AIG Life Insurance Company with an effective date of October 1, 2010 and an expiration date of September 30, 2011. The specific excess of loss coverage has an attachment point of \$175,000, per individual, and a limit of liability of \$4,875,000 in excess of the attachment point, per individual; however, the Trust is not eligible for recoveries against claims paid until the aggregate amount for all individual claims that have exceeded the individual attachment point have surpassed an additional \$100,000 deductible. The aggregate excess of loss coverage (applicable to aggregate claims paid during the reinsurance term) has a minimum attachment point of \$50,452,870 and a limit of liability of \$1,000,000 in excess of the attachment point. Contributions and health claims ceded to the reinsurer during the year ended September 30, 2011 amounted to \$1,067,647 and \$854,240, respectively.

## North Carolina Bar Association Health Benefit Trust

### Notes to Financial Statements (Continued)

#### **Note D - General Expenses**

General expenses include all underwriting expenses incurred during the day-to-day operations of the Trust. General expenses incurred during the years ended September 30, 2012 and 2011 were comprised of the following:

	2012	2011
BCBS administration fees	\$ 2,098,405	\$ 2,087,332
Lawyers Insurance Agency administration fees	1,557,010	1,578,920
Consulting fees	95,000	95,000
Actuarial fees	44,486	47,212
Insurance expense	58,058	69,048
Other	62,987	52,775
Unrelated Business Income Tax Expense	337,945	-
Accounting fees	24,628	21,900
Legal fees	56	284
Total general expenses	\$ 4,278,575	\$ 3,952,471

#### **Note E - Health Claims Liability**

The following represents the change in the health claims liability for the Trust during the years ended September 30, 2012 and 2011:

	2012	2011
Net health claims liability, beginning of year	\$ 1,422,355	\$ 2,026,388
Provision for health claims incurred during:		
Current year	25,341,181	26,059,091
Previous years	(470,310)	321,245
Total provision for health claims incurred	24,870,871	26,380,336
Health claims paid for claims, net of reinsurance, incurred during:		
Current year	23,083,475	24,884,265
Previous years	609,819	2,100,104
Total health claims paid	23,693,294	26,984,369
Net health claims liability, end of year	\$ 2,599,932	\$ 1,422,355
Gross health claims liability, end of year	\$ 2,599,932	\$ 1,422,355
Less: Reinsurance recoverable on unpaid claims	-	-
Net health claims liability, end of year	\$ 2,599,932	\$ 1,422,355

# North Carolina Bar Association Health Benefit Trust

## Notes to Financial Statements (Continued)

### Note E - Health Claims Liability (continued)

As reflected in the preceding table, the reserve for health claims attributable to insured events of prior fiscal years has decreased by \$470,310 and increased by \$321,245 during fiscal years 2012 and 2011, respectively, as a result of re-estimation of unpaid health claims. Such changes are generally the result of ongoing analysis of recent claims development trends.

### Note F - Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for plan benefits per the financial statements to Form 5500:

	<u>2012</u>	<u>2011</u>
Net assets available for plan benefits per the financial statements	\$ 18,257,058	\$ 14,048,991
Health claims currently payable	<u>2,599,932</u>	<u>1,422,355</u>
Net assets available for benefits per Form 5500	<u>\$ 15,657,126</u>	<u>\$ 12,626,636</u>

The following is a reconciliation of benefits paid per the financial statements to Form 5500:

	<u>2012</u>	<u>2011</u>
Benefits to participants per the financial statements	\$ 23,693,294	\$ 26,984,369
Add: Amounts currently payable at end of period	2,599,932	1,422,355
Less: Amounts currently payable at beginning of period	<u>1,422,355</u>	<u>2,026,388</u>
Benefits to participants per Form 5500	<u>\$ 24,870,871</u>	<u>\$ 26,380,336</u>

## North Carolina Bar Association Health Benefit Trust

Schedule H, line 4i - Schedule of Assets Held for Investment Purposes  
Employer Identification Number 56-6595155, Plan Number 501

September 30, 2012

Identity of issue, borrower, lessor or similar party	Description of investment	Cost	Current value
Morgan Keegan	Cash	\$ 7,396,737	\$ 7,396,737
Dreyfus Government Cash Management	Money Market	2,805,642	2,805,642
GNMA #AB2764; 2.500%; due 08/15/27	Bond	520,444	528,116
Federal Farm Credit Bank;; 1.470%; due 06/27/18	Bond	499,833	502,895
Federal Farm Credit Bank; 1.900% due 12/21/17	Bond	500,636	501,505
Federal Farm Credit Bank; 1.330%; due 12/07/15	Bond	500,671	501,025
Federal Home Loan Bank; 1.080%; due 09/06/17	Bond	499,755	500,940
Federal Home Loan Banks; 1.50%; due 11/16/16	Bond	499,483	500,760
Federal Farm Credit Bank; .890%; due 12/12/14	Bond	500,000	500,730
Federal Farm Credit Bank; .750%; due 12/19/14	Bond	499,814	500,640
Federal Farm Credit Bank; .850% due 11/7/2014	Bond	499,566	500,365
Federal Home Loan Bank; 1.000%; due 11/28/18	Bond	499,709	500,345
Federal Farm Credit Bank; .800%; due 11/23/16	Bond	499,640	500,160
Federal Home Loan Bank; 1.00%; due 09/11/17	Bond	500,346	500,055
Federal Farm Credit Bank;; 1.190%; 09/28/17	Bond	499,287	500,045
Federal Home Loan Bank; .830%; due 07/05/16	Bond	499,412	500,035
Federal Farm Credit Bank;; 1.250%; pending settlement	Bond	499,501	499,500
GNMA II #5012; 3.500%; due 04/20/26	Bond	424,744	447,662
GNMA #783308; 3.500%; due 05/15/26	Bond	434,536	445,114
GNMA #738040; 3.500%; due 03/15/26	Bond	413,774	431,850
Total		<u>\$ 18,993,530</u>	<u>\$ 19,064,121</u>