



**BASIC FINANCIAL STATEMENTS, REQUIRED  
SUPPLEMENTARY INFORMATION, AND  
OTHER FINANCIAL INFORMATION**

**West Virginia Public Employees Insurance Agency  
Years Ended June 30, 2010 and 2009  
With Report of Independent Auditors**

Ernst & Young LLP

 **ERNST & YOUNG**

West Virginia Public Employees Insurance Agency

Basic Financial Statements, Required Supplementary Information,  
and Other Financial Information

Years Ended June 30, 2010 and 2009

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## Report of Independent Auditors

The Finance Board  
West Virginia Public Employees Insurance Agency

We have audited the accompanying basic financial statements of the West Virginia Public Employees Insurance Agency (PEIA), an enterprise fund of the State of West Virginia, as of June 30, 2010 and 2009, and for the years then ended, as listed in the table of contents. These financial statements are the responsibility of PEIA'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of 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. We were not engaged to perform an audit of PEIA's internal control over financial reporting. Our audits included 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 PEIA'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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

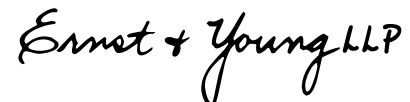
As discussed in Note 1, the financial statements of PEIA are intended to present the financial position, the changes in financial position, and the cash flows of only that portion of the business-type activities of the State of West Virginia that is attributable to the transactions of PEIA. They do not purport to, and do not, present fairly the financial position of the State of West Virginia as of June 30, 2010 and 2009, the changes in its financial position, or, where applicable, its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PEIA, an enterprise fund of the State of West Virginia, as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2010, on our consideration of PEIA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our 2010 audit.

Management's discussion and analysis on pages 3 through 8 and the supplemental schedule of Ten-Year Claims Development Information on page 40 are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of PEIA, taken as a whole. Other financial information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of PEIA. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads 'Ernst & Young LLP'.

October 15, 2010

# West Virginia Public Employees Insurance Agency

## Management's Discussion and Analysis

Year Ended June 30, 2010

This section of the annual financial report of the West Virginia Public Employees Insurance Agency (PEIA) presents a discussion and analysis of the financial performance of PEIA for the year ended June 30, 2010. Please read it in conjunction with the basic financial statements, which follow this section.

### OVERVIEW OF THE FINANCIAL STATEMENTS

PEIA's basic financial statements are prepared in accordance with U.S. generally accepted accounting principles for governmental entities. The primary purpose of PEIA is to provide group health and prescription drug insurance for the employees of state agencies, colleges and universities, county school boards, and other governmental units as set forth in the West Virginia Public Employees Insurance Act of 1971 as amended. PEIA operates in a manner similar to any other insurance company. PEIA is an enterprise fund of the State of West Virginia and is combined with other similar funds to comprise the enterprise funds of the State of West Virginia. The basic financial statements are presented on the accrual basis of accounting. The three basic financial statements presented within the financial statements are as follows:

*Statement of Net Assets* – This statement presents information reflecting PEIA's assets, liabilities, and net assets. Net assets represent the amount of total assets less total liabilities. The statement of net assets is categorized as to current and noncurrent assets and liabilities. For purposes of the basic financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or become due within 12 months of the statement date.

*Statement of Revenues, Expenses, and Changes in Net Assets* – This statement reflects PEIA's operating revenues and expenses, as well as nonoperating revenues during the fiscal year. The major source of operating revenues is premium income, while major expense areas include medical and prescription drug claims costs. The change in net assets for an enterprise fund is similar to net profit or loss for any other insurance company.

*Statement of Cash Flows* – The statement of cash flows is presented on the direct method of reporting which reflects cash flows from operating, capital, and investing activities. Cash collections and payments are reflected in this statement to arrive at net increase or decrease in cash for the fiscal year.

# West Virginia Public Employees Insurance Agency

## Management's Discussion and Analysis (continued)

### FINANCIAL HIGHLIGHTS

The following tables summarize the financial position and the changes in financial position as of and for the years ended June 30:

	2010	2009	2008	Change 2010 – 2009		Change 2009 – 2008	
				Amount	Percent	Amount	Percent
Cash and cash equivalents	\$ 5,045,348	\$ 2,700,245	\$ 15,425,536	\$ 2,345,103	86.8%	\$ (12,725,291)	(82.5)%
Equity position in internal investment pool	53,584,267	33,294,218	40,382,507	20,290,049	60.9	(7,088,289)	(17.6)
Premium receivable	16,339,136	26,466,755	14,355,794	(10,127,619)	(38.3)	12,110,961	84.4
Other current assets	30,682,749	6,682,408	13,730,357	24,000,341	359.2	(7,047,949)	(51.3)
Total current assets	<b>105,651,500</b>	69,143,626	83,894,194	<b>36,507,874</b>	<b>52.8</b>	(14,750,568)	(17.6)
Equity position in internal investment pools	<b>131,127,040</b>	115,072,492	122,360,685	<b>16,054,548</b>	<b>14.0</b>	(7,288,193)	(6.0)
Equity position in internal investment pool – restricted	7,738,706	7,738,658	7,738,658	48	–	–	–
Capital assets, net	5,760,478	6,495,407	5,153,924	(734,929)	(11.3)	1,341,483	26.0
Total assets	<b>250,277,724</b>	198,450,183	219,147,461	<b>51,827,541</b>	<b>26.1</b>	(20,697,278)	(9.4)
Claims payable	64,455,468	56,461,892	51,276,816	7,993,576	14.2	5,185,076	10.1
Other current liabilities	4,479,415	25,017,598	56,827,048	(20,538,183)	(82.1)	(31,809,450)	(56.0)
Total current liabilities	<b>68,934,883</b>	81,479,490	108,103,864	<b>(12,544,607)</b>	<b>(15.4)</b>	(26,624,374)	(24.6)
Noncurrent liabilities:							
Premium stabilization fund	7,738,658	7,738,658	7,738,658	–	–	–	–
Total liabilities	<b>76,673,541</b>	89,218,148	115,842,522	<b>(12,544,607)</b>	<b>(14.1)</b>	(26,624,374)	(23.0)
Net assets – invested in capital assets	5,760,478	6,495,407	5,153,924	(734,929)	(11.3)	1,341,483	26.0
Net assets – unrestricted	167,843,705	102,736,628	98,151,015	65,107,077	63.4	4,585,613	4.7
Total net assets	<b>\$ 173,604,183</b>	\$ 109,232,035	\$ 103,304,939	<b>\$ 64,372,148</b>	<b>58.9%</b>	\$ 5,927,096	5.7%
Premium revenue	\$ 542,095,539	\$ 464,263,863	\$ 416,040,777	\$ 77,831,676	16.8%	\$ 48,223,086	11.6%
Less: Payments to managed care organizations and life reinsurance premiums	(60,911,524)	(60,186,506)	(60,595,834)	(725,018)	(1.2)	409,328	0.7
Net premium revenue	481,184,015	404,077,357	355,444,943	77,106,658	19.1	48,632,414	13.7
Administrative fees, net	4,742,682	4,693,824	4,487,011	48,858	1.0	206,813	4.6
Total operating revenues	<b>485,926,697</b>	408,771,181	359,931,954	<b>77,155,516</b>	<b>18.9</b>	48,839,227	13.6
Claims expense, net	412,334,128	371,015,676	419,370,075	41,318,452	11.1	(48,354,399)	(11.5)
Administrative service fees	15,971,306	14,810,235	12,820,798	1,161,071	7.8	1,989,437	15.5
Other expenses	9,372,861	10,107,845	6,764,371	(734,984)	(7.3)	3,343,474	49.4
Total operating expenses	<b>437,678,295</b>	395,933,756	438,955,244	<b>41,744,539</b>	<b>10.5</b>	(43,021,488)	(9.8)
Operating income	<b>48,248,402</b>	12,837,425	(79,023,290)	<b>35,410,977</b>	<b>275.8</b>	91,860,715	116.2
Transfer out	(262)	(7,320)	–	7,058	96.4	(7,320)	(100.0)
Net investment income (loss)	16,124,008	(6,903,009)	7,978,307	23,027,017	333.6	(14,881,316)	(186.5)
Total nonoperating (loss) income	<b>16,123,746</b>	(6,910,329)	7,978,307	<b>23,034,075</b>	<b>333.3</b>	(14,888,636)	(186.6)
Change in net assets	<b>64,372,148</b>	5,927,096	(71,044,983)	<b>58,445,052</b>	<b>986.1</b>	76,972,079	108.3
Net assets, beginning of year	<b>109,232,035</b>	103,304,939	174,074,569	<b>5,927,096</b>	<b>5.7</b>	(70,769,630)	(40.7)
Change in accounting principle for other postemployment benefits	–	–	275,353	–	–	(275,353)	(100.0)
Net assets, end of year	<b>\$ 173,604,183</b>	\$ 109,232,035	\$ 103,304,939	<b>\$ 64,372,148</b>	<b>58.9%</b>	\$ 5,927,096	5.7%

## West Virginia Public Employees Insurance Agency

### Management's Discussion and Analysis (continued)

The current portion of equity position in internal investment pool and cash and cash equivalents increased \$22.6 million as the result of \$47.3 million produced from operations less \$23.6 million advanced to the Retiree Health Benefit Trust (RHBT), and \$1.1 million used for the purchase of capital assets.

In the previous year, the decrease of cash and cash equivalents and the current portion of equity position in internal investment pool of \$19.8 million was the result of \$26.1 million used in operations, \$6.9 million used to cover investment losses, and \$7.3 million was provided from liquidation of investments, \$2.8 million was used to purchase capital assets, and \$8.7 million was advanced to RHBT.

Premium receivable at June 30, 2010 was \$10.1 million less than the prior year because of several large employers who held their premium last year-end that did not do so this year.

As of the previous year-end, premiums receivable were \$12.1 million more than the prior year because several large employers did not remit their premium until after year-end.

Other current assets were up \$24.0 million as of the end of this year because \$22.1 million was advanced to RHBT, prescription receivable increased \$1.1 million because the Pharmacy Benefit Manager has begun quarter remittance in the current year from monthly remittance, provider refunds receivable is up \$.4 million and other increases of \$.4 million.

At year-end 2009, other current assets were down \$7.0 million due to a \$7.2 million advance to RHBT having been collected, prescription rebates receivable were up \$.5 million and provider refunds receivable were down \$.3 million.

Claims payable increased \$8.0 million due to increased enrollment and medical cost inflation. In fiscal year 2009, this liability increased \$5.2 million due to the same reasons.

Other current liabilities decreased \$20.5 million mainly resulting from the elimination of the \$15.6 million deficiency reserve, repayments of \$1.5 million to RHBT, and a \$3.4 million reduction of accounts payable and other current liabilities.

In the previous year, other current liabilities decreased \$31.8 million mainly resulting from a reduction of premium deficiency reserve by \$27.7 million, \$4.7 million decrease in accounts payable, \$1.9 million reduction of accrued liabilities, less an advance from RHBT of \$1.5 million and \$1.0 million increase in unearned revenue.

## West Virginia Public Employees Insurance Agency

### Management's Discussion and Analysis (continued)

In 2010, the increase in net assets resulted from an increase in premium of \$77.8 million, primarily achieved through increased policy premium rates, recovery of market value of investments producing an improvement of \$23.0 million, and a reduction of \$.7 million of other operating expenses. These improvements were offset by increased claim costs of \$41.3 million, increased administrative service fees of \$1.2 million, and an increase of \$.7 million in payments to managed care organizations.

The 2009 increase in net assets resulted primarily from an increase in premium revenue of \$48.2 million over prior year and lower claim costs, less investment losses.

Net premiums increased \$77.1 million mainly due to premium increases and reduction of paygo passthrough to RHBT, a further reduction of \$.8 million in provision for uncollectible accounts offset by an increase of \$.7 million in managed care and life insurance expenses.

In the prior year, net premiums increased \$48.6 million as a result of a reduction in the pass-through of post-employment benefit funding to RHBT, a \$6.8 million decrease in provision for uncollectible accounts, and changes in policyholder counts.

Medical and prescription drug claims were 94% of total plan operating expenses for the three-year period. In the current year, claims expense was reduced by \$15.6 million to write-off the premium deficiency reserve. Additionally, claims experience indicates a 5.7% increase in medical claims and a 13.6% increase in drug claims, net of premium deficiency. Fiscal year 2009 included a \$27.7 million reduction to reduce the deficiency reserve and reflected a net 5.8% increase in medical claims and a 6.8% increase in drug claims.

Administrative service fees and other expenses have averaged approximately 5% to 6% of plan operating expenses for the three-year period. Administrative service fees expense increased 7.8% due to expanded services written into new contracts, which became effective in 2010. Other expenses decreased 7.3% primarily due to \$0.7 million decrease in wellness spending, \$0.4 increase in depreciation and \$0.3 reduction of professional fees and computer services. In the prior year, administrative service fees expense increased 15.5% due to replacement of old contracts with new higher fee contracts, while other expenses increased 49.4% primarily due to \$0.9 million increase in wellness spending, \$1.1 million increase in depreciation relating to a new computer system.

During fiscal year 2010, PEIA recovered the prior-year investment loss, as markets recovered, and ended the year with \$23.0 million above year 2009. For the previous year, a decrease of \$14.9 million from the prior year was recognized.



## West Virginia Public Employees Insurance Agency

### Management's Discussion and Analysis (continued)

Net assets increased \$64.4 million in fiscal year 2010. The 2010 increase resulted primarily from a \$45.8 million increase produced by rate increases, \$18.0 million reduction in the pass-through of post-employment benefit funding to RHBT, reduction of claims expense of \$15.6 million to adjust the year-end premium deficiency reserve, \$29.7 million increase in claims incurred, and improved investment income. The financial plan for 2010 indicated a decrease in total net assets of \$13.5 million. However, it did not include the \$15.6 million reduction of expense related to the premium deficiency reserve. Total claim costs for the current year were \$40.2 million less, investment income was \$8.9 million above plan, premium revenues were \$19.0 million more, managed care capitations were \$10.2 million less than plan and other non-claim expenses were \$0.4 million more than plan.

In the prior year, net assets increased \$5.9 million. This increase resulted primarily from a reduction of claim expenses of \$27.7 million to adjust the year-end premium deficiency reserve; lower than expected claim expenses were partially offset by investment losses. When the reduction of the premium deficiency is excluded, the year 2009 net asset change becomes negative \$21.8 million. Premium rate increases totaling \$6.0 million were adopted for year 2009. The financial plan for last year indicated a decrease in total net assets of \$46.8 million. However, it did not include the \$27.7 million reduction of expense related to the premium deficiency reserve. Total claim costs were \$18.4 million less, investment loss was \$6.9 million more, and non-claim expenses were \$0.8 million more than plan.

### **ECONOMIC CONDITIONS**

After allowing for the contribution to help fund retiree health care costs, which is included in the active policyholder premium amount, PEIA's average active employee family monthly premium cost is \$772.31 compared to the national average cost of \$1,169.42. It should be noted that PEIA achieved an increase in plan assets of \$48.8 million, excluding the effect of eliminating the prior-year premium deficiency reserve.

Actuaries have estimated that the new federal Patient Protection and Affordable Care Act will cost PEIA policyholders and employers between \$30 million and \$38 million per year beginning with fiscal year 2012. It has been reported, based on inescapable relevant science, that many high-ticket medical interventions, which account for the majority of the direct cost of health care, either do not advantage patients at all or do so minimally. New U.S. Department of Health and Human Services rules are expected to be completed in 2013, which aim to improve quality of care. The rules require the exchange of patient data in structured formats, the use of "evidence-based medicine," and the use of standards and best practices for treating patients. It is hoped that the new evidence-based medicine requirement will significantly reduce health care costs and provide better medical outcomes for all.

## West Virginia Public Employees Insurance Agency

### Management's Discussion and Analysis (continued)

In 2010, PEIA's claims costs rose 7.5%. State employee premium rates were increased 11.6%, state employer premium rates were increased 8.5%, and local employer premium rates were increased 15.1%. No pay increases were granted to the state employees. The 2010 premium increases have reduced disposable incomes of policyholders and stressed the operations of their employers.

Premium increases totaling \$22.5 million were placed into effect for the year that began July 1, 2010.

#### **CAPITAL ASSET AND LONG-TERM DEBT ACTIVITY**

During fiscal year 2008, PEIA adopted Governmental Accounting Standard Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, in conjunction with our implementation of new computer software. Following the provisions of Statement No. 51, we capitalized computer software costs of \$1.0 million, \$2.7 million and \$4.5 million in fiscal years ended 2010, 2009 and 2008, respectively. These additions are expected to result in additional annual depreciation over the next five years of \$210,000, \$540,000 and \$900,000, respectively (see Note 6).

PEIA has no long-term debt.

#### **REQUEST FOR INFORMATION**

This financial report is designed to provide PEIA's customers, governing officials, legislators, citizens, and taxpayers with a general overview of PEIA's accountability for the money it receives. If you have questions about this report or need additional information, contact the Chief Financial Officer at (304) 558-7850.

# West Virginia Public Employees Insurance Agency

## Statements of Net Assets

	June 30	
	2010	2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 5,045,348	\$ 2,700,245
Equity position in internal investment pool	53,584,267	33,294,218
Premiums receivable:		
Due from State of West Virginia	2,010,784	2,324,756
Other, less allowance for doubtful accounts of \$4,025,000 and \$4,971,000, respectively	14,328,352	24,141,999
Accounts receivable:		
Provider refunds, less allowance for doubtful accounts of \$635,000 and \$452,000, respectively	828,917	469,046
Prescription rebates	7,091,216	5,960,234
Due from RHBT	22,105,569	–
Other	657,047	253,128
Total current assets	105,651,500	69,143,626
Noncurrent assets:		
Equity position in internal investment pools	131,127,040	115,072,492
Equity position in internal investment pool – restricted	7,738,706	7,738,658
Capital assets, net of accumulated depreciation of \$4,199,981 and \$2,393,849, respectively	5,760,478	6,495,407
Total noncurrent assets	144,626,224	129,306,557
Total assets	250,277,724	198,450,183
<b>Liabilities</b>		
Current liabilities:		
Claims payable	64,455,468	56,461,892
Premium deficiency reserve	–	15,588,245
Accounts payable	1,475,560	3,078,470
Unearned revenue	583,523	1,329,780
Other accrued liabilities	2,420,332	3,483,904
Due to RHBT	–	1,537,199
Total current liabilities	68,934,883	81,479,490
Noncurrent liabilities:		
Other accrued liabilities: Premium stabilization fund	7,738,658	7,738,658
Total liabilities	76,673,541	89,218,148
<b>Net assets</b>		
Invested in capital assets	5,760,478	6,495,407
Unrestricted	167,843,705	102,736,628
Total net assets	\$ 173,604,183	\$ 109,232,035

*See accompanying notes.*

West Virginia Public Employees Insurance Agency

Statements of Revenues, Expenses, and Changes in Net Assets

	<b>Year Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Operating revenues:		
Premiums net of provisions for bad debts of \$(762,000) and \$(1,291,000), respectively	<b>\$ 542,095,539</b>	\$ 464,263,863
Less:		
Payments to managed care organizations	(55,278,092)	(54,666,461)
Life insurance premiums ceded	(5,633,432)	(5,520,045)
Net premium revenue	<b>481,184,015</b>	404,077,357
Administrative fees, net of refunds	4,742,682	4,693,824
Total operating revenues	<b>485,926,697</b>	408,771,181
Operating expenses:		
Claims expense, net	412,334,128	371,015,676
Administrative service fees	15,971,306	14,810,235
Other expenses	9,372,861	10,107,845
Total operating expenses	<b>437,678,295</b>	395,933,756
Operating income	<b>48,248,402</b>	12,837,425
Nonoperating revenues (expenses):		
Investment income (loss), net of fees	16,124,008	(6,903,009)
Transfer out	(262)	(7,320)
Total nonoperating income (loss)	<b>16,123,746</b>	(6,910,329)
Change in net assets	<b>64,372,148</b>	5,927,096
Total net assets, beginning of year	<b>109,232,035</b>	103,304,939
Total net assets, end of year	<b>\$ 173,604,183</b>	\$ 109,232,035

*See accompanying notes.*

# West Virginia Public Employees Insurance Agency

## Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Cash received from participants	\$ 494,921,545	\$ 396,466,817
Cash received from pharmacy rebates	12,607,269	13,632,097
Cash paid to employees	(1,497,116)	(1,564,977)
Cash paid to suppliers and others	(26,215,658)	(27,503,967)
Cash paid for claims	(432,536,066)	(407,176,268)
Net cash provided by (used in) operating activities	47,279,974	(26,146,298)
<b>Non-capital financing activities</b>		
Advances (to) from RHBT	(23,642,768)	8,716,092
Transfers	(262)	(7,320)
Net cash (used in) provided by noncapital financing activities	(23,643,030)	8,708,772
<b>Capital and related financing activities</b>		
Purchases of capital assets	(1,071,203)	(2,761,240)
Net cash used in capital and related financing activities	(1,071,203)	(2,761,240)
<b>Investing activities</b>		
Purchases of investments	(41,417,116)	(89,145,903)
Sale of investments	38,868,421	81,735,951
Investment earnings	2,618,154	7,795,138
Net cash provided by investing activities	69,459	385,186
Net increase (decrease) in cash and cash equivalents	22,635,200	(19,813,580)
Cash and cash equivalents at beginning of year	43,733,121	63,546,701
Cash and cash equivalents at end of year	\$ 66,368,321	\$ 43,733,121
Cash and cash equivalents consist of:		
Cash and cash equivalents	\$ 5,045,348	\$ 2,700,245
Equity position in internal investment pool – current	53,584,267	33,294,218
Equity position in internal investment pool – restricted	7,738,706	7,738,658
	\$ 66,368,321	\$ 43,733,121
<b>Reconciliation of operating income to net cash used in operating activities</b>		
Operating income	\$ 48,248,402	\$ 12,837,425
<b>Adjustments</b>		
Depreciation	1,806,134	1,419,757
Provision for uncollectible accounts	(762,000)	(1,291,000)
Decrease (increase) in operating assets:		
Premiums receivable	10,575,646	(9,650,508)
Due from State of West Virginia	313,972	(1,169,453)
Provider refunds receivable	(359,871)	322,968
Prescription refunds receivable	(1,130,982)	(423,004)
Other	(403,919)	(30,908)
Increase (decrease) in operating liabilities:		
Claims payable	7,993,576	5,185,076
Accounts payable	(1,602,910)	(4,682,065)
Premium deficiency	(15,588,245)	(27,713,571)
Unearned revenue	(746,257)	972,536
Other accrued liabilities	(1,063,572)	(1,923,551)
Total adjustments	(968,428)	(38,983,723)
Net cash used in operating activities	\$ 47,279,974	\$ (26,146,298)
<b>Noncash activities</b>		
Increase (decrease) in fair value of investments	\$ 13,505,854	\$ (14,698,145)

See accompanying notes.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements

June 30, 2010

### **1. Reporting Entity**

The State of West Virginia Public Employees Insurance Agency (PEIA) was established under the Public Employees Insurance Act of 1971 (Act). PEIA is an agency of the State of West Virginia and, accordingly, is reported as an enterprise fund of the primary government in the State's Comprehensive Annual Financial Report (CAFR).

PEIA provides the following basic employee benefit coverage to all participants: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug coverage for active employees of the State of West Virginia (State) and various related State and non-State agencies. Additionally, all participants may elect to purchase additional life insurance under the optional life insurance policy. All premium rates are established based upon projected coverage costs as reviewed and approved by the Finance Board of PEIA. See "Budgetary Requirements" for further discussion of this process. PEIA's enrollment consists of approximately 75,000 health and basic life insurance policyholders, and 14,000 policyholders with life insurance only. PEIA insures approximately 177,000 individuals, including participants and dependents.

During the 2006 Regular Session of the West Virginia Legislature, House Bill 4654 was enacted creating the West Virginia Retiree Health Benefit Trust (RHBT) Fund for the purpose of providing for and administering retiree post-employment health care benefits, and the respective revenues and costs of those benefits as a cost-sharing multiple employer plan. As a consequence of the legislation, health insurance policies covering approximately 34,000 retirees and their dependents, along with the related revenues, claims costs, and expenses were transferred to RHBT effective July 1, 2006. RHBT and PEIA jointly share administrative duties relating to the other post-employment benefit (OPEB) operations. Both entities are housed in the same office space and share expenses. Expenses directly attributable to the OPEB plan are charged to RHBT. Other operating expenses, except personnel, are allocated based on policyholder count between PEIA and RHBT. Personnel expenses attributable to three dedicated employees are charged in full to RHBT; while the balance of the combined expense is allocated between the two entities based on estimated time requirements.

The basic financial statements of PEIA are intended to present the financial position, changes in financial position, and cash flows of only that portion of the business-type activities of the State of West Virginia that is attributable to the transactions of PEIA. They do not purport to, and do not, present fairly the financial position of the State of West Virginia as of June 30, 2010 and 2009, and the changes in its financial position or, where applicable, its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles (GAAP).

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **2. Summary of Significant Accounting Policies**

#### **Basis of Reporting**

PEIA operates as an enterprise fund. Accordingly, the financial statements of PEIA have been prepared on the accrual basis in conformity with GAAP for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB). Revenues mainly are derived from premiums earned net of related reinsurance premiums, plus administrative fees billed. Expenses consist primarily of claims, administrative service fees, and various general and administrative costs.

In September 1993, GASB issued Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. As permitted by the Statement, PEIA has elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless GASB specifically adopts such FASB statements or interpretations.

#### **Annual Financial Plan**

The Act requires the Finance Board of PEIA to prepare a proposed annual financial plan. The plan must be designed to generate sufficient revenues to meet all expected expenses, including insurance, administrative expenses, and incurred but not reported claims (IBNR) of PEIA. An independent professional actuary must review the plan and give an opinion stating that the plan may be reasonably expected to generate sufficient revenue to meet estimated insurance claims and administrative expenses. The financial plan must be presented to the governor and the legislature no later than January 1, prior to the beginning of the new plan year.

PEIA Finance Board establishes PEIA premiums based upon its approved annual financial plan. The financial plan projects the anticipated costs of the program for each fiscal year and the premium levels necessary to meet these costs. Any variances between projected and incurred costs are incorporated into subsequent financial plans and subsequent premiums are adjusted accordingly on a prospective basis. Premiums assessed by PEIA are not subject to retroactive adjustment based upon actual costs incurred.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **2. Summary of Significant Accounting Policies (continued)**

#### **Cash and Cash Equivalents**

Cash and cash equivalents include short-term investments with original maturities of 90 days or less. Cash and cash equivalents principally consist of amounts on deposit with the West Virginia State Treasurer's office, outside financial institutions, and amounts deposited in an internal investment pool managed by the West Virginia Board of Treasury Investments (BTI) that is reported as part of equity position in internal investment pool – current-unrestricted and noncurrent-restricted, respectively.

#### **Premiums Receivable**

All premiums receivable are reported at their gross premium value due from employers and individual subscribers. The gross value is then reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

#### **Accounts Receivable**

Accounts receivable include overpayments made by third-party administrators that are due to PEIA and estimated prescription refunds and rebates that are due PEIA from third-party administrators and other drug companies. The estimated prescription refunds/rebate receivable is based upon estimated prescription claim count and historical average rebate per claim. These receivables have been reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

#### **Equity Position in Internal Investment Pools**

PEIA owns equity positions in state government investment pools managed by the West Virginia Investment Management Board (WVIMB) and the BTI. Some investment pool funds are subject to market risk because of changes in interest rates, bond prices, and stock prices. Investment earnings and losses are allocated to PEIA based on the balance of PEIA's investments maintained in relation to the total investments of all state agencies participating in the pool. The equity position in internal investment pools is reported at fair value and changes in fair value are included in investment income.



# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **2. Summary of Significant Accounting Policies (continued)**

A 13-member Board of Trustees governs the WVIMB. Three members of the Board serve by virtue of their office: the Governor, the Auditor, and the Treasurer. The other ten are appointed by the Governor and confirmed by the Senate. All appointees must have experience in pension management, institutional management or financial markets. In addition, one must be an attorney experienced in finance and investment matters and another must be a Certified Public Accountant. Only six of the ten appointed Trustees may be from the same political party. The Governor serves as Chairman of the Board. A Vice-Chairman is elected by the Trustees. A Secretary, who need not be a member of the Board, is also elected by the Trustees to keep a record of the proceedings of the Board. Details regarding these investment pools and a copy of the WVIMB financial report can be obtained by contacting: West Virginia Investment Management Board, 500 Virginia Street, East, Suite 200, Charleston, West Virginia 25301 or by calling +1 304 645 5939.

A five-member Board of Directors governs the BTI. The Governor, Treasurer, and Auditor serve as ex-officio members of the Board. The Governor appoints the two remaining members subject to the advice and consent of the State Senate. Of the two members appointed by the Governor, one shall be a certified public accountant and one shall be an attorney, and both shall have experience in finance, investing, and management. The State Treasurer is Chairman of the Board. The BTI prepares separately issued financial statements covering the pooled fund, which can be obtained from its website or a published copy from the West Virginia Board of Treasury Investments, 1900 Kanawha Boulevard, East, Building 1, Room E-122, Charleston, West Virginia 25305.

### **Capital Assets**

Capital assets with an initial cost of \$1,000 or greater are recorded at cost. PEIA has assigned a useful life of three to five years for capital assets. Depreciation expense computed using the straight-line method was \$1,806,132 and \$1,419,757 for the years ended June 30, 2010 and 2009, respectively.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Claims Payable and Expense

The liability for unpaid claims and claims processing costs is based on an actuarial estimate of the ultimate cost of settling such claims incurred as of the statement of net assets date (including claims reported and in process of settlement, claims reported but not yet processed for settlement, and claims incurred but not yet reported or processed for settlement). The estimated actuarial liability reflects certain assumptions, which include such factors as enrollment, utilization, inflation, and other societal and economic factors. Adjustments to the estimated actuarial liability for the final settlement of claims will be reflected in the year that the actual results of the settlement of the claims are made and are known. The estimated liability is adjusted annually based on the most current claim incurrence and claim settlement history (see Note 7). Year-end claims payable balances are generally liquidated within the next fiscal year. Claims relating to participants in managed care organizations (MCOs) as well as claims relating to participants covered under the optional life insurance plan are not considered in the liability, as PEIA has no liability for the participants who elect such coverage. Additionally, the estimated liability for unpaid claims and claims processing costs is recorded net of amounts ceded to reinsurers for basic life benefits, as management believes these reinsured risks are fully recoverable. However, in the event a reinsurer is unable financially to satisfy an obligation, PEIA is responsible for such liability. Claims expense is reported net of pharmacy rebate income of \$13,738,251 and \$14,055,101 for the years ended June 30, 2010 and 2009, respectively.

#### Premium Deficiency Reserve

Premium deficiency is required when policies in force as of the financial statement date are expected to produce a loss when claims cost (including IBNR), plus expected claims adjustment expenses, are expected to exceed related premiums. Management has recorded a premium deficiency reserve of \$15,588,245 as of June 30, 2009. No such reserve was required as of the end of fiscal year 2010. In making its determination, management took into consideration anticipated premium revenue and claims costs. PEIA did not include anticipated investment income in determining whether a premium deficiency exists. Adjustments to the estimated premium deficiency liability are reflected as a change in estimate in the year the actual results are known.

PEIA participants are not subject to supplemental assessment in the event of a premium deficiency. At the time of premium payment, the risk of loss due to incurred benefit costs is transferred from the participant to PEIA. If the assets of PEIA were to be exhausted, participants would not be responsible for the liabilities.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **2. Summary of Significant Accounting Policies (continued)**

#### **Unearned Revenue**

Unearned revenue includes premium revenues collected for future contract periods. These revenues will be recognized in the operating periods in which they are earned.

#### **Insurance Programs and Related Premium Revenues**

PEIA offers the following types of coverage to its participants: health coverage through a self-insured preferred provider benefit (PPB) plan, health coverage through external MCOs, and life and accidental death and dismemberment (AD&D) insurance benefits under basic and optional plans. PEIA collects premiums for participants in the PPB plan and uses these premiums in the administration of the plan. Additionally, PEIA has the statutory authority to raise additional revenues in the form of premiums without the need for external (legislative) action.

For participants who elect coverage through MCOs, PEIA collects premiums from employers and remits a capitation fee to an MCO carrier. The capitation fees paid by PEIA to each MCO are in accordance with their respective contracts. Benefits are the responsibility of each MCO carrier. The premiums earned by PEIA have been included in gross premium revenue while the capitation fees submitted to each MCO carrier are reflected as payments to MCOs on the financial statements.

As of the June 2010 coverage month, PEIA provided health coverage to 121 state agency divisions with approximately 22,000 primary participants (not including dependents), 55 county school boards with approximately 32,000 primary participants, 547 local government entities with approximately 11,000 primary participants, and 23 college and university entities with approximately 10,000 primary participants. Approximately 88,000 dependents participated in PEIA health plans as well.

As of the June 2009 coverage month, PEIA provided health coverage to 119 state agency divisions with approximately 22,000 primary participants (not including dependents), 55 county school boards with approximately 32,000 primary participants, 539 local government entities with approximately 10,000 primary participants, and 23 college and university entities with approximately 10,000 primary participants. Approximately 91,000 dependents participated in PEIA health plans as well.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **2. Summary of Significant Accounting Policies (continued)**

Employees covered through PEIA are eligible to obtain life insurance coverage under basic and optional life insurance plans. Basic life benefits and AD&D benefits of \$10,000 are provided to active state employees under the age of 65 at no cost to the employee. Coverage amounts decrease with age. No AD&D benefits are available to retirees. Basic life benefits are available to retirees with coverage ranging from \$2,500 to \$5,000 depending on age. For these basic life benefits, PEIA collects premiums and submits them to the insurance carrier. PEIA has reinsured 100% of these basic benefits; however, PEIA remains contingently liable in the event the insurer does not honor its obligation. The premiums earned for basic life insurance are reflected in gross premiums and the related amounts ceded to the reinsurer are reflected as life reinsurance premiums on the financial statements.

Active employees may elect to obtain additional optional coverage for both life and AD&D with coverage from \$5,000 to \$500,000 that decreases with age. Active employees may also elect dependent optional life coverage and AD&D at a level up to \$20,000 per spouse and \$10,000 per child. Retirees may obtain optional life insurance coverage from \$5,000 to \$150,000 depending on age; however, optional AD&D insurance is not available to retirees. Retirees may also elect dependent optional life coverage at levels up to \$20,000 for spouse and \$10,000 per child. Amounts collected by PEIA from employees for optional coverage totaled \$13,707,677 and \$13,417,453 during the fiscal years ended June 30, 2010 and 2009, respectively, and were remitted directly to the carrier. In this instance, PEIA functions as an agent and, accordingly, neither these premiums nor the related costs are reflected in the financial statements.

Revenues include an administrative fee that PEIA charges to all participating entities in the plan. The fee is based on the participating entities' number of employees enrolled in the plan.

#### **Administrative Service Fees**

PEIA contracts with and pays administrative service fees to two third-party administrators. Services include processing of insurance claims, precertification reviews, utilization reviews, and various other duties. The majority of related fees are assessed each month based upon the number of covered participants or claims processed at predetermined rates without regard to the period in which a claim is incurred, processed, or settled.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Compensated Absences, Including Postretirement Benefits

Employees fully vest in all earned but unused annual leave and PEIA accrues for obligations that may arise in connection with compensated absences for vacation at the current rate of employee pay. In accordance with state personnel policies, employees vest in any remaining unused sick leave only upon retirement, at which time any unused compensated absence time can be converted into employer paid premiums for postretirement health care coverage through RHBT, or be converted into a greater retirement benefit under the state's Public Employees' Retirement System.

#### Operating Revenues and Expenses

Balances classified as operating revenues and expenses are those that comprise PEIA's ongoing operations. Principal operating revenues include health insurance premiums, life insurance premiums, and insurance administration fees, less amounts paid to managed care organizations and life insurance reinsurers. Operating expenses include the cost of medical claims, drug claims, claims adjudication, administration, and depreciation of capital assets. Other revenues and expenses are classified as nonoperating in the financial statements.

#### Net Assets

As required by GASB Statement 34, PEIA displays net assets in three components, if applicable: invested in capital assets, net of related debt; restricted; and unrestricted.

*Invested in Capital Assets, Net of Related Debt* – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

*Unrestricted Net Assets* – Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." In the governmental environment, net assets are often *designated* to indicate that management does not consider them to be available for general operations. These types of constraints on resources are internal and management can remove or modify them. Such internal designations are not reported on the face of the statements of net assets.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

West Virginia Code Section 5-16-25 requires the Finance Board of PEIA to maintain a reserve of 10% of projected plan costs for general operation purposes and provide future plan stability. As of June 30, 2010 and 2009, PEIA has sufficient net assets to comply with this code section. In the event the reserve fund exceeds 15% of the actuarial recommended reserve of 20% to 25% of total projected costs, the excess was to be remitted to the State of West Virginia Department of Administration. Accordingly, excess reserves of \$80,487,422 and \$27,679,595 were due to be transferred for years ended 2007 and 2006, respectively. Senate Bill 129, which became effective July 1, 2007, amended 5-16-25 indicating that the excess reserve funds shall be transferred to the West Virginia Retiree Health Benefit Trust Fund beginning in fiscal 2008. Accordingly, the monies were transferred to RHBT in fiscal year 2008. There were no excess reserves to be transferred for the years ended June 30, 2010 or 2009.

### 3. Cash and Cash Equivalents

Following is a summary of PEIA's cash and cash equivalents as of June 30:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents on deposit with State Treasurer	\$ 3,744,497	\$ 1,399,113
Deposits with outside financial institutions	<u>1,300,851</u>	<u>1,301,132</u>
Cash and cash equivalents reported on statement of net assets	<b>5,045,348</b>	2,700,245
Equity position in internal investment pool with BTI – current-unrestricted	<b>53,584,267</b>	33,294,218
Equity position in internal investment pool with BTI – noncurrent-restricted	<u>7,738,706</u>	<u>7,738,658</u>
Total cash and cash equivalents	<u><b>\$ 66,368,321</b></u>	<u>\$ 43,733,121</u>

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **4. Deposit and Investment Risk Disclosures**

#### **Deposits with Outside Financial Institutions**

##### *Custodial Credit Risk*

Custodial credit risk is the risk that, in the event of a bank failure, PEIA's deposits might not be recovered. PEIA has no deposit policy for custodial credit risk.

As of June 30, 2010 and 2009, the carrying amount of PEIA's bank deposits was \$1,300,851 and \$1,301,132, respectively, and the respective bank balances totaled \$1,430,000 and \$1,511,042, respectively. Of the total bank balance, \$1,428,856 and \$1,510,741, respectively, were uninsured and collateralized with government-sponsored enterprise securities held by financial institutions. These securities are held in the name of the financial institution and not that of PEIA.

#### **West Virginia Money Market Pool (Formerly Cash Liquidity Pool) – Equity Position in Internal Investment Pool – Current – Managed by BTI**

##### *Credit Risk*

The BTI administers the pool and limits exposure to credit risk by requiring all corporate bonds held by their West Virginia Money Market Pool to be rated AA- by Standard & Poor's (or its equivalent) or higher. Commercial paper must be rated at least A-1 by Standard & Poor's and P1 by Moody's. Additionally, the pool must have at least 15% of its assets in United States Treasury issues.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

The following table provides information on the credit ratings of the West Virginia Money Market Pool's investments (in thousands).

Security Type	June 30, 2010		Carrying Value	Percent of Pool Assets
	Credit Rating			
	Moody's	S&P		
Commercial paper	P1	A-1	\$ 855,844	29.75%
Corporate bonds and notes	Aa1	AA	10,000	0.35
	Aa2	AA	10,000	0.35
Total corporate bonds and notes			20,000	0.70
U.S. agency bonds	Aaa	AAA	246,990	8.59
U.S. Treasury notes*	Aaa	AAA	65,153	2.26
U.S. Treasury bills*	Aaa	AAA	476,670	16.57
Negotiable certificates of deposit	P1	A-1	281,000	9.77
U.S. agency discount notes	P1	A-1	606,048	21.07
Money market funds	Aaa	AAA	150,026	5.21
Repurchase agreements (underlying securities):				
U.S. Treasury notes*	Aaa	AAA	101,280	3.52
U.S. agency notes	Aaa	AAA	73,700	2.56
Total repurchase agreements			174,980	6.08%
Total investments			\$ 2,876,711	100.00%

\* U.S. Treasury issues are explicitly guaranteed by the United States government and are not subject to credit risk.

*Custodial Credit Risk*

Repurchase agreements included in BTI's investment portfolio are collateralized by at least 102% of their value and the collateral is held in the name of the BTI. Securities lending collateral is invested in the lending agent's money market fund in BTI's name.



West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

*Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. All pools and accounts are subject to interest rate risk.

The overall weighted-average maturity of the investments of the West Virginia Money Market Pool cannot exceed 60 days. Maximum maturity of individual securities cannot exceed 397 days from date of purchase. The following table provides information on the weighted-average maturities (WAM) for the various asset types in the West Virginia Money Market Pool.

Security Type	Carrying Value	WAM (Days)
	<i>(In Thousands)</i>	
Repurchase agreements	\$ 174,980	1
U.S. Treasury notes	65,153	140
U.S. Treasury bills	476,670	35
Commercial paper	855,844	18
Negotiable certificates of deposit	281,000	45
U.S. agency discount notes	606,048	52
Corporate bonds and notes	20,000	19
U.S. agency bonds/notes	246,990	55
Money market funds	150,026	1
	\$ 2,876,711	33

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **4. Deposit and Investment Risk Disclosures (continued)**

PEIA's investment in the BTI West Virginia Money Market Pool of \$61,322,973 at June 30, 2010, represents approximately 2.1% of total investments in this pool.

### **Equity Position in Internal Investment Pools – Noncurrent-Unrestricted Managed by WVIMB**

#### **PEIA Fund**

This investment fund was specifically designed for PEIA by WVIMB based on PEIA's unique cash flow needs. PEIA is the only state agency participating in this fund and owns 100% of the total assets. The fund invests in various pools managed by WVIMB.

West Virginia statute mandates that the PEIA Fund shall be managed by WVIMB, a public corporation.

#### **Investment Objectives**

This fund's investment objective is to achieve a total rate of return of at least 5.54% per annum, net of fees.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

**Asset Allocation**

Based upon the WVIMB's determination of the appropriate risk tolerance for the fund, the WVIMB has adopted the following broad asset allocation guidelines for the assets managed for the PEIA Fund. (Policy targets have been established on a market value basis.) The asset values of the pools below are reported in equity position in internal investment pools – noncurrent-unrestricted on the statement of net assets.

Asset Class	Strategic Target	
	2010	2009
Domestic equity	7.5%	7.5%
International equity	7.5	7.5
Total equity	15.0%	15.0%
Fixed income	65.0%	65.0%
Hedge fund	20.0%	20.0%
	Asset Value at June 30	
	2010	2009
	<i>(In Thousands)</i>	
<b>Asset allocation (actual)</b>		
Large cap domestic equity pool	\$ 7,297	\$ 7,324
Non-large cap domestic equity pool	1,383	1,313
International non-qualified pool	3,282	3,054
International equity pool	6,204	6,258
Short-term fixed income pool	1	1
Total return fixed income	42,750	53,033
Core fixed income	44,179	21,406
Hedge fund	26,031	22,683
Total	\$ 131,127	\$ 115,072

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **4. Deposit and Investment Risk Disclosures (continued)**

#### **Asset Class Risk Disclosures**

##### *Large Cap Domestic Equity Pool*

This pool holds equity securities of U.S. companies and money market funds with the highest credit rating. PEIA's amount invested in the Large Cap Domestic Equity Pool of \$7,297,000 and \$7,324,000 at June 30, 2010 and 2009, respectively, represents approximately 0.43% and 0.41%, respectively, of total investments in this pool.

##### *Non-Large Cap Domestic Equity Pool*

This pool holds equity securities of U.S. companies and money market funds with the highest credit rating. PEIA's amount invested in the Non-Large Cap Domestic Equity Pool of \$1,383,000 and \$1,313,000 at June 30, 2010 and 2009, respectively, represents approximately 0.40% and 0.41%, respectively, of total investments in this pool.

##### *International Non-qualified Pool*

This pool holds an institutional mutual fund that invests in equities denominated in foreign currencies. West Virginia statute limits the amount of international securities to no more than 30% of the total assets managed by the WVIMB. The value of this investment was \$53,797,000 and \$101,246,000 at June 30, 2010 and 2009, respectively. This investment, although denominated in U.S. dollars, is exposed to foreign currency risk through underlying investments. The specific currencies of the underlying investments were not available. West Virginia statute limits the amount of international securities to no more than 30% of the total assets managed by the WVIMB. PEIA's amount invested in the International Non-qualified Pool of \$3,282,000 and \$3,054,000 at June 30, 2010 and 2009, respectively, represents approximately 6.10% and 3.02%, respectively, of total investments in this pool.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 4. Deposit and Investment Risk Disclosures (continued)

#### *International Equity Pool*

This pool has both equity securities and cash that are denominated in foreign currencies and are exposed to foreign currency risk. West Virginia statute limits the amount of international securities to no more than 30% of the total assets managed by the WVIMB. PEIA's amount invested in the International Equity Pool of \$6,204,000 and \$6,258,000 at June 30, 2010 and 2009, respectively, represents approximately 0.41% and 0.42%, respectively, of total investments in this pool. The amounts (in U.S. dollars) of the securities and cash denominated in foreign currencies as of June 30 were as follows:

Currency	2010		
	Equity Securities	Cash	Total
	<i>(In Thousands)</i>		
Australian Dollar	\$ 28,001	\$ 8	\$ 28,009
Brazil Cruzeiros Real	82,624	1,605	84,229
British Pound Sterling	141,897	435	142,332
Canadian Dollar	58,467	59	58,526
Czech Koruna	10,106	5	10,111
Danish Krone	7,115	6	7,121
Egyptian Pound	741	12	753
Euro Currency Unit	242,635	379	243,014
Hong Kong Dollar	137,405	848	138,253
Hungarian Forint	11,994	39	12,033
Indian Rupee	1,938	1	1,939
Indonesian Rupiah	4,049	24	4,073
Israeli Shekel	22,323	-	22,323
Japanese Yen	162,122	1,834	163,956
Malaysian Ringitt	10,960	206	11,166
Mexican New Peso	23,959	422	24,381
New Taiwan Dollar	51,582	2,875	54,457
New Turkish Lira	44,480	1	44,481
New Zealand Dollar	1,025	-	1,025
Norwegian Krone	11,570	33	11,603
Pakistani Rupee	923	-	923
Philippine Peso	6,158	15	6,173
Polish Zloty	7,912	5	7,917
Singapore Dollar	29,787	113	29,900
South African Rand	38,417	132	38,549
South Korean Won	103,072	1,207	104,279
Swedish Krona	18,257	45	18,302
Swiss Franc	41,481	417	41,898
Thailand Baht	8,775	180	8,955
<b>Total</b>	<b>\$ 1,309,775</b>	<b>\$ 10,906</b>	<b>\$ 1,320,681</b>

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

This table excludes cash and securities held by the pool that are denominated in U.S. dollars. The fair value of the U.S. dollar denominated cash and securities is \$185,968,000.

*Short-Term Fixed Income Pool*

*Credit Risk*

The WVIMB limits the exposure to credit risk in the Short-Term Fixed Income Pool by requiring all corporate bonds to be rated AA or higher. Commercial paper must be rated A1 by Standard & Poor's and P1 by Moody's. Additionally, the pool must have at least 15% of its assets in United States Treasury issues.

The following table provides information on the weighted-average credit ratings of the Short-Term Fixed Income Pool's investments as of June 30, 2010.

Security Type	Moody's	S&P	2010	
			Carrying Value	Percent
			<i>(In Thousands)</i>	
Agency discount notes	P-1	A-1	\$ 89,973	29.3%
U.S. Treasury note	Aaa	AAA	25,572	8.4
Commercial paper	P-1	A-1	38,997	12.7
U.S. Treasury bills	Aaa	AAA	126,984	41.4
Agency notes	Aaa	AAA	24,999	8.2
Money market fund	Aaa	AAA	1	0.0
Total rated investments			<u>\$ 306,526</u>	<u>100.0%</u>

This table includes securities received as collateral for repurchase agreements with a fair value of \$70,971,000 as compared to the amortized cost of the repurchase agreements of \$69,861,000.

*Custodial Credit Risk*

Repurchase agreements are collateralized at 102% and the collateral is held in the name of the WVIMB.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

*Interest Rate Risk*

The weighted-average maturity of the investments of the Short-Term Fixed Income Pool is not to exceed 60 days. The maturity of floating rate notes is assumed to be the next interest rate reset date. The following table provides the weighted-average maturities (WAM) for the various asset types in the Short-Term Fixed Income Pool as of June 30, 2010.

Security Type	2010	
	Carrying Value	WAM (days)
	<i>(In Thousands)</i>	
Repurchase agreements	\$ 69,861	1
U.S. Treasury bills	81,586	32
Commercial paper	38,997	11
Agency discount notes	89,973	48
Agency notes	24,999	41
Money market fund	1	1
Total assets	<u>\$ 305,417</u>	<u>28</u>

PEIA's amount invested in the Short-Term Fixed Income Pool at June 30, 2010 and 2009, was nominal.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

*Total Return Fixed Income Pool*

*Credit Risk*

The WVIMB limits the exposure to credit risk in the Total Return Fixed Income Pool by maintaining at least an average rating of investment grade as defined by the Nationally Recognized Statistical Rating Organizations. The following table provides the weighted-average credit ratings of the asset types in the fixed income pool as of June 30, 2010.

Security Type	Moody's	S&P	2010	
			Fair Value	Percent of Assets
			<i>(In Thousands)</i>	
Agency mortgage-backed securities	Aaa	AAA	\$ 200,978	11.2%
Money market funds	Aaa	AAA	268,245	14.9
Corporate bonds and notes	Baa	BBB	572,512	31.8
Corporate collateralized mortgage obligations	Ba	BB	65,134	3.6
U.S. Treasury inflation protection bonds	Aaa	AAA	30,997	1.7
Agency notes	Aa	A	4,004	0.2
U.S. Treasury bonds and notes	Aaa	AAA	165,854	9.2
Corporate preferred securities	NR	NR	891	0.0
Corporate asset-backed securities	Aaa	AAA	13,213	0.7
Agency collateralized mortgage obligations	Aaa	AAA	7,258	0.4
Municipal Bonds	Aa	A	26,929	1.5
Total rated investments			<u>\$ 1,356,015</u>	<u>75.2%</u>

Unrated securities include commingled investment pools valued at \$441,720,000 and a contract purchased valued at \$1,349,000. These unrated securities represent 24.8% of the fair value of the pool's investments.

*Custodial Credit Risk*

At June 30, 2010, the Total Return Fixed Income Pool held no securities that were subject to custodial credit risk. Repurchase agreements, when held, are collateralized at 102% and the collateral is held in the name of the WVIMB. Investments in commingled funds are held in an account in the name of the WVIMB. All remaining securities are held by the WVIMB's custodian in the name of the WVIMB. Securities lending collateral is invested in the lending agent's money market fund.



West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

*Interest Rate Risk*

The WVIMB monitors interest rate risk of the Total Return Fixed Income Pool by evaluating the modified duration of the investments in the pool. The following table provides the weighted-average modified duration for the various asset types in the Total Return Fixed Income Pool as of June 30, 2010.

<b>Security Type</b>	<b>Fair Value</b>	<b>Modified Duration (Years)</b>
	<i>(In Thousands)</i>	
Commingled investment pools	\$ 441,720	0.5
Agency mortgage-backed securities	200,978	3.8
Money market fund	268,245	0.0
Corporate notes and bonds	572,512	6.3
Corporate collateralized mortgage obligations	65,134	4.8
U.S. Treasury inflation protection bonds	30,997	13.1
Agency notes	4,004	2.0
U. S. Treasury notes and bonds	165,854	3.9
Corporate asset-backed securities	13,213	17.5
Agency collateralized mortgage obligations	7,258	5.2
Municipal Bonds	26,929	17.7
Total assets	<u>\$ 1,796,844</u>	<u>4.1</u>

The Total Return Fixed Income Pool invests in commercial and residential mortgage-backed and asset-backed securities. The cash flows from these securities are based on the payment of the underlying collateral. The modified duration and yield to maturity of these securities are dependent on estimated prepayment assumptions that consider historical experience, market conditions, and other criteria. Actual prepayments may vary with changes in interest rates. Rising interest rates often result in a slower rate of prepayments while declining rates tend to lead to faster prepayments. As a result, the fair values of these securities are highly sensitive to interest rate changes. The Total Return Fixed Income Pool held \$286,583,000 and \$623,449,368 of these securities at June 30, 2010 and 2009, respectively, which represented approximately 16% and 24%, respectively, of the value of the Total Return Fixed Income Pool.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 4. Deposit and Investment Risk Disclosures (continued)

PEIA's amount invested in the Total Return Fixed Income Pool of \$42,750,000 and \$53,033,000 at June 30, 2010 and 2009, respectively, represented approximately 2.38% and 2.00%, respectively, of total investments in the pool.

#### *Core Fixed Income Pool*

#### *Credit Risk*

The WVIMB limits the exposure to credit risk in the Core Fixed Income Pool by maintaining at least an average rating of investment grade as defined by the Nationally Recognized Statistical Rating Organizations. The following table provides the weighted-average credit ratings of the rated assets in the Core Fixed Income Pool as of June 30, 2010.

Security Type	Moody's	S&P	Fair Value	Percent of Assets
<i>(In Thousands)</i>				
Agency collateralized mortgage obligations	Aaa	AAA	\$ 245,849	15.7%
Agency mortgage-backed securities	Aaa	AAA	138,487	8.9
U.S. Treasury bonds and notes	Aaa	AAA	334,152	21.4
Corporate bonds and notes	A	A	153,804	9.9
Corporate collateralized mortgage obligations	Aa	AAA	122,349	7.9
Money market funds	Aaa	AAA	53,413	3.4
Corporate asset-backed securities	Aaa	AAA	10,679	0.7
Agency notes	Aaa	AAA	13,494	0.9
Municipal bonds	Aa	A	273	0.0
Total rated investments			\$ 1,072,500	68.8%

Unrated securities include a commingled investment pool valued at \$488,243,000. The unrated securities represent 31.2% of the fair value of the pool's investments.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**4. Deposit and Investment Risk Disclosures (continued)**

*Interest Rate Risk*

The WVIMB monitors interest rate risk of the Core Fixed Income Pool by evaluating the modified duration of the investments in the pool. The following table provides the weighted-average modified duration for the various asset types in the Core Fixed Income Pool as of June 30, 2010.

<b>Security Type</b>	<b>Fair Value</b>	<b>Modified Duration (Years)</b>
	<i>(In Thousands)</i>	
Agency collateralized mortgage obligations	\$ 245,849	3.7
Agency mortgage-backed securities	138,487	3.0
U.S. Treasury bonds and notes	334,152	5.8
Corporate bonds and notes	153,804	5.9
Corporate collateralized mortgage obligations	122,349	3.4
Money market funds	53,413	0.0
Corporate asset-backed securities	10,679	1.7
Commingled investment pools	488,243	4.3
Agency notes	13,494	6.0
Municipal bonds	273	12.0
Total assets	<u>\$ 1,560,743</u>	<u>4.4</u>

The Core Fixed Income Pool invests in commercial and residential mortgage-backed securities, asset-backed securities, and collateralized mortgage obligations. The cash flows from these securities are based on the payment of the underlying collateral. The modified duration and yield to maturity of these securities are dependent on estimated prepayment assumptions that consider historical experience, market conditions, and other criteria. Actual prepayments may vary with changes in interest rates. Rising interest rates often result in a slower rate of prepayments while declining rates tend to lead to faster prepayments. As a result, the fair values of these securities are highly sensitive to interest rate changes. At June 30, 2010, the Core Fixed Income Pool held \$44,179,058 of these securities. This represents approximately 33.7% of the value of the pool's securities.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **4. Deposit and Investment Risk Disclosures (continued)**

PEIA's amount invested in the Core Fixed Income Pool of \$44,179,000 at June 30, 2010, represented approximately 2.83% of total investments in this pool. At June 30, 2009, PEIA had \$21,406,000, which represented approximately 5.28% of total investments in this pool.

#### *Hedge Fund Pool*

The Hedge Fund Pool holds shares in various commingled institutional funds and shares of a money market fund with the highest credit rating. The commingled institutional funds are not rated by any of the nationally recognized statistical rating agencies and thus any credit risk cannot be accurately reported. The pool is indirectly exposed to foreign currency risks as certain of the funds have investments denominated in foreign currencies. West Virginia statute limits the amount of international securities to no more than 30% of the total assets managed by the WVIMB. At June 30, 2010, approximately \$393,329,000 or 35.00%, of the market value of the funds were held in foreign currencies. PEIA's amount invested in the Hedge Fund Pool of \$26,031,000 and \$22,683,000 at June 30, 2010 and 2009, respectively, represented approximately 2.34% and 2.04%, respectively, of total investments in this pool.

### **5. Equity Position in Internal Investment Pool – Restricted (Premium Stabilization Fund) Managed by BTI**

Optional life insurance premiums are funded entirely by program participants. The premium stabilization fund consists of accumulated dividends and interest on the participant optional life insurance policies. The premium stabilization fund is invested in the BTI Money Market Pool. See pages 21 to 24 for investment risk disclosures related to this pool. To the extent that these policyholder premiums are refunded to PEIA in the form of dividends and interest by the life insurance company, the funds are refunded to the related optional life policyholders by way of reductions in future premium increases. This account is utilized to track the accumulated balance due to optional life policyholders. Cash and cash equivalents include \$7,738,706 as of June 30, 2010 and 2009, restricted to meet this obligation.

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**5. Equity Position in Internal Investment Pool – Restricted (Premium Stabilization Fund)  
Managed by BTI (continued)**

The following table represents changes in the premium stabilization fund for the years ended June 30:

	<b>2010</b>	<b>2009</b>
Premium stabilization fund – beginning of the year	<b>\$ 7,738,658</b>	\$ 7,738,658
Life insurance dividends and interest refunds received	<b>48</b>	–
Premium stabilization fund – end of year	<b>\$ 7,738,706</b>	\$ 7,738,658

**6. Capital Assets**

Capital asset activity for the years ended June 30, 2010 and 2009, was as follows:

	<b>June 30 2009</b>	<b>Additions</b>	<b>Disposals</b>	<b>June 30 2010</b>
<i>(In Thousands)</i>				
Intangible assets	\$ 7,670	\$ 1,060	\$ –	\$ <b>8,730</b>
Equipment	1,219	11	–	<b>1,230</b>
Total capital assets	8,889	1,071	–	<b>9,960</b>
Intangible assets	(1,590)	(1,699)	–	<b>(3,289)</b>
Equipment	(804)	(107)	–	<b>(911)</b>
Total accumulated depreciation	(2,394)	(1,806)	–	<b>(4,200)</b>
Total capital assets, net	\$ 6,495	\$ (735)	\$ –	\$ <b>5,760</b>

West Virginia Public Employees Insurance Agency

Notes to Financial Statements (continued)

**6. Capital Assets (continued)**

	<b>June 30 2008</b>	<b>Additions</b>	<b>Disposals</b>	<b>June 30 2009</b>
Intangible assets	\$ 5,014	\$ 2,656	\$ –	\$ 7,670
Equipment	1,114	105	–	1,219
Total capital assets	6,128	2,761	–	8,889
Intangible assets	(282)	(1,307)	–	(1,590)
Equipment	(692)	(113)	–	(804)
Total accumulated depreciation	(974)	(1,420)	–	(2,394)
Total capital assets, net	\$ 5,154	\$ 1,341	\$ –	\$ 6,495

**7. Unpaid Claims Liabilities**

As discussed in Note 2, PEIA establishes a liability for both reported and unreported insured events, which includes an estimate of future payments of losses. The following represents changes in those aggregate liabilities for PEIA for the years ended June 30:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<i>(In Thousands)</i>		
Claims payable, beginning of year	\$ 56,462	\$ 51,277	\$ 52,999
Incurred claims expenses:			
Provision for insured events of the current year	427,392	400,289	377,099
Increase (decrease) in provision for insured events of prior years	530	(1,560)	(1,030)
Total incurred claims expense	427,922	398,729	376,069
Payments:			
Claim payments attributable to insured events of:			
Current year	375,571	354,773	335,380
Prior years	44,358	38,771	42,411
Total payments	419,929	393,544	377,791
Claims payable, end of year	\$ 64,455	\$ 56,462	\$ 51,277

The above payments are net of pharmacy rebates of \$12,607,269, \$13,632,097, and \$11,842,611 for the years ended June 30, 2010, 2009, and 2008, respectively.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### 8. Employee Benefit Plans

All full-time PEIA employees are eligible to participate in the State of West Virginia Public Employees Retirement System (PERS), a cost-sharing, multiple-employer, public employee retirement system. Employees who retire at or after age 60 with 5 or more years of contributory service or who retire at or after age 55 and have completed 25 years of credited service are eligible for retirement benefits as established by state statute. Retirement benefits are payable monthly for life, in the form of a straight-line annuity equal to 2% of the employee's final average salary, multiplied by the number of years of the employee's credited service at the time of retirement. PERS also provides deferred retirement, early retirement, and death and disability benefits, and issues an annual report that can be obtained by contacting PERS.

Covered employees are required to contribute 4.5% of their salary to PERS. Effective July 1, 2009, the PEIA contribution rate was increased to 11.0%. PEIA was required to contribute 10.5% of covered employees' salaries to PERS through year-end 2009. The required employee and employer contribution percentages are determined by actuarial advisement within ranges set by statute. PEIA and employee contributions, both the statutorily required and actual contributions made, for the three years ended June 30 are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Employer contributions	\$ 167,945	\$ 163,469	\$ 167,079
Employee contributions	68,705	70,058	71,605
Total contributions	<u>\$ 236,650</u>	<u>\$ 233,527</u>	<u>\$ 238,684</u>

PEIA's contributions to the retirement plan for each of the years indicated above were equal to its required contributions. The contributions are included in other operating expenses in the basic financial statements.

The Consolidated Public Retirement Board (CPRB) administers the state's retirement systems. CPRB prepares separately issued financial statements covering the state's retirement systems, including PERS, which can be obtained from the Consolidated Public Retirement Board, 4101 MacCorkle Avenue, S.E., Charleston, West Virginia 25304-1636.

# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **9. Postemployment Benefits Other Than Pension Benefits**

#### **Other Postemployment Benefits**

PEIA participates in a cost-sharing, multiemployer, defined benefit other post-employment benefit plan that covers the retirees of state agencies, colleges and universities, county boards of education, and other government entities as set forth in the West Virginia Code. Financial activities of the OPEB plan are accounted for in the RHBT. The plan provides the following retiree group insurance coverage to participants: medical and prescription drug coverage through a self-insured plan and through external managed care organizations, basic group life, accidental death, and prescription drug coverage for retired employees of the state and various related state and non-state agencies and their dependents. Details regarding this plan and a copy of the RHBT financial report can be obtained by contacting Public Employees Insurance Agency, 601 57<sup>th</sup> Street Southeast, Suite 2, Charleston, West Virginia 25304-2345 or by calling +1 888 680 7342.

Upon retirement, an employee may apply unused sick leave and/or annual leave to reduce their future insurance premiums paid to RHBT. Substantially all employees hired prior to July 1, 2001, may become eligible for these benefits if they reach normal retirement age while working for PEIA. According to West Virginia State Code, employees hired prior to June 30, 1988, can receive health care credit against 100% of their health care coverage. Employees hired between June 30, 1988 and June 30, 2001, can receive health care credit against 50% of their health care cost. Employees hired July 1, 2001, or later, may not convert sick leave into a health care benefit.

Legislation requires RHBT to determine through an actuarial study, the contractually required contribution (CRC) that shall be sufficient to maintain the RHBT in an actuarially sound manner. The CRC is allocated to respective cost-sharing employers, including PEIA, who are required by law to fund at least the minimum annual premium component of the CRC. Revenues collected by RHBT shall be used to fund current OPEB health care claims and administrative expenses with residual funds held in trust for future OPEB costs. Based on the actuarial studies completed, the contractually required contribution rates were determined for the fiscal year ended June 30, 2010, 2009, and 2008. PEIA's contributions to the RHBT were \$55,596, \$63,800, and \$81,900 for fiscal years 2010, 2009, and 2008, respectively, which represent 16.0%, 48.5%, and 49.4%, respectively, of the contractually required contributions. The cumulative unpaid balances of \$384,690, \$98,000, and \$30,000 for fiscal years 2010, 2009, and 2008, respectively, is recorded in other accrued liabilities in the statements of net assets. The State, on PEIA's behalf, paid \$43,000 toward the annual required contribution for fiscal year 2008.



# West Virginia Public Employees Insurance Agency

## Notes to Financial Statements (continued)

### **9. Postemployment Benefits Other Than Pension Benefits (continued)**

The West Virginia State Code provides that contribution requirements of the members and the participating employers are established and may be amended by the RHBT Finance Board. A non-Medicare plan member or beneficiaries receiving benefits contributes monthly premiums ranging from \$227 to \$812 per month for retiree only coverage, and from \$457 to \$1,937 per month for retiree and spouse coverage. Medicare covered retirees are charged premiums ranging from \$46 to \$349 per month for retiree only coverage, and from \$249 to \$1,176 per month for retiree and spouse coverage. Monthly premiums vary based on years of service and choice of coverage.

### **10. Litigation**

PEIA is engaged in various legal actions that it deems to be in the ordinary course of business. PEIA believes that it has adequately provided for probable costs of current litigation. As these legal actions are resolved, however, PEIA could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately decided.

# Required Supplementary Information

# West Virginia Public Employees Insurance Agency

## Ten-Year Claims Development Information (Unaudited)

The table below illustrates how PEIA's earned premiums (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by PEIA as of the end of each of the years presented. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned and ceded premiums, administrative fees, other operating, and investment revenues. (2) This line shows each fiscal year's other operating costs of PEIA including overhead and unallocated claims expense not allocable to individual claims. (3) This line shows PEIA's incurred and ceded claims and allocated claims adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage occurred (called accident year). (4) These lines show the cumulative amounts paid as of the end of successive years for each accident year. (5) This line shows the most current estimate of losses assumed by reinsurers for each accident year. (6) These lines show how each accident year's incurred claims increased or decreased as of the end of successive years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (7) This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual accident years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature accident years. The columns of the table show data for successive accident years.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<i>(In Thousands)</i>										
1) Premiums, investment, and other revenues:										
Earned	\$ 417,673	\$ 432,220	\$ 501,170	\$ 575,420	\$ 591,470	\$ 657,858	\$ 502,666	\$ 433,959	\$ 460,756	\$ 562,962
Ceded	76,656	51,962	56,730	61,833	55,846	62,467	59,228	60,596	60,187	60,912
Net earned	341,017	380,258	444,440	513,587	535,624	595,391	443,438	373,363	400,569	502,050
2) Unallocated expenses	16,754	16,531	21,195	23,347	23,579	26,036	20,321	25,038	23,627	25,344
3) Estimated incurred claims and allocated claims adjustment expense, end of accident year:										
Incurred	388,645	431,544	450,592	493,230	542,512	580,561	419,070	437,694	460,476	488,304
Ceded	76,656	51,962	56,730	61,833	55,846	62,467	59,228	60,596	60,187	60,912
Net incurred	311,989	379,582	393,862	431,397	486,666	518,094	359,842	377,098	400,289	427,392
4) Paid (cumulative) claims and allocated claims adjustment expense as of:										
End of accident year	262,116	327,451	343,939	379,101	426,562	460,973	320,480	335,380	354,773	375,571
One year later	310,090	374,269	390,420	428,176	487,303	507,194	362,605	373,609	398,798	
Two years later	310,047	374,685	388,999	428,218	487,237	507,479	363,147	373,942		
Three years later	309,981	374,465	388,911	428,218	487,237	507,479	363,147			
Four years later	309,981	374,465	388,911	428,218	487,237	507,479				
Five years later	309,981	374,465	388,911	428,218	487,237					
Six years later	309,981	374,465	388,911	428,218						
Seven years later	309,981	374,465	388,911							
Eight years later	309,981	374,465								
Nine years later	309,981									
5) Reestimated ceded claims and expenses	76,656	51,962	56,730	61,833	55,846	62,467	59,228	60,596	60,187	-
6) Reestimated net incurred claims and allocated claims adjustment expense:										
End of accident year	311,989	379,582	393,862	431,397	486,666	518,094	359,842	377,099	400,289	427,392
One year later	319,539	375,350	389,662	428,567	487,656	517,884	358,832	374,948	401,109	
Two years later	319,306	375,050	389,162	428,687	487,536	517,854	359,112	374,778		
Three years later	319,076	374,920	389,352	428,687	487,556	518,154	359,002			
Four years later	319,076	374,920	389,352	428,687	487,556	518,144				
Five years later	319,076	374,920	389,352	428,687	487,556					
Six years later	319,076	374,920	389,352	428,687						
Seven years later	319,076	374,920	389,352							
Eight years later	319,076	374,920								
Nine years later	319,076									
7) Increase (decrease) in estimated net incurred claims and allocated claims adjustment expense from end of accident year	7,087	(4,662)	(4,510)	(2,710)	890	50	(840)	(2,320)	820	-

Note: The above financial data is summarized for individual contract periods. Subsequent premium and related expense adjustments and reserve developments are recorded in the year incurred for fiscal year financial reporting but are included in the applicable contract year for purposes of the above schedule. Accordingly, components of change in net assets as determined on a contract-year basis will differ from that included in PEIA's fiscal year financial statements.

# Other Financial Information

West Virginia Public Employees Insurance Agency

Deposits Disclosure

Form 7

June 30, 2010

	<u>Carrying Amount</u>
Cash with Treasurer	\$ 3,744,497
Deposit in transit	
Cash in outside bank accounts	<u>1,300,851</u>
Total carrying amount of deposits	5,045,348
Cash equivalents (with BTI)	<u>61,322,973</u>
Total cash	<u><u>\$ 66,368,321</u></u> (1)

(1) Agrees to audited statement of net assets as follows:

Cash and cash equivalents	\$ 5,045,348
Equity position in internal investment pool – current	53,584,267
Equity position in internal investment pool – noncurrent and restricted	<u>7,738,706</u>
Total cash equivalents	<u><u>\$ 66,368,321</u></u> (2)

(2) Agrees to audited statement of cash flows.

# West Virginia Public Employees Insurance Agency

## Investments Disclosure

Form 8

June 30, 2010

Investment Pool	Amount Unrestricted	Amount Restricted	Amount Reported	Fair Value
West Virginia Board of Treasury				
Investments (BTI):				
WV Money Market Pool	\$ 61,322,973	\$ –	\$ 61,322,973	\$ 61,322,973
Total equity position in internal investment pool with BTI	<u>\$ 61,322,973</u>	<u>\$ –</u>	<u>\$ 61,322,973</u>	<u>\$ 61,322,973</u>
West Virginia Investment Management				
Board (IMB) Investment Pools:				
Short-term fixed income	\$ –	\$ –	\$ –	\$ –
Total return fixed income	42,749,623	–	42,749,623	42,749,623
Core fixed income	44,179,058	–	44,179,058	44,179,058
Large cap domestic	7,297,142	–	7,297,142	7,297,142
Non-large cap domestic	1,383,271	–	1,383,271	1,383,271
International nonqualified	3,282,297	–	3,282,297	3,282,297
Hedge fund	26,031,132	–	26,031,132	26,031,132
International equity	6,204,516	–	6,204,516	6,204,516
Total equity position in internal investment pools with IMB	<u>\$ 131,127,040</u>	<u>\$ –</u>	<u>\$ 131,127,040</u>	<u>\$ 131,127,040</u> (1)

(1) Agrees to audited statement of net assets as follows:

Equity position in internal investment pool – current	\$ 53,584,267
Equity position in internal investment pools – noncurrent	131,127,040
Equity position in internal investment pool – noncurrent and restricted	<u>7,738,706</u>
Total equity position in internal investment pools	<u>\$ 192,450,013</u>

West Virginia Public Employees Insurance Agency

Deposits and Investments Disclosure

Form 8-A

June 30, 2010

Reconciliation of cash and cash equivalents and investments as reported in the financial statements to the amounts disclosed in the footnotes:

Cash and cash equivalents as reported	<u>\$ 5,045,348</u> (1)
---------------------------------------	-------------------------

Equity position in internal investment pools as reported	<u>\$ 192,450,013</u> (2)
--	---------------------------

(1) Agrees to audited statement of net assets.

(2) Agrees to Form 8.

West Virginia Public Employees Insurance Agency

Accounts Receivable

Form 9

June 30, 2010

Total accounts receivable	\$ 51,681,885 (1)
Less allowance for doubtful accounts	<u>(4,660,000) (1)</u>
Net receivable	<u><u>\$ 47,021,885</u></u>

(1) Agrees to audited statement of net assets as follows:

Premium receivable:

Due from State of West Virginia	\$ 2,010,784 (2)
Other, net	14,328,352 (2)
Add allowance for doubtful accounts	<u>4,025,000 (2)</u>

Accounts receivable:

Provider refunds, net	828,917 (2)
Add allowance for doubtful accounts	635,000 (2)
Prescription rebates	7,091,216 (2)
Due from RHBT	22,105,569 (2)
Other	<u>657,047 (2)</u>
Total accounts receivable	<u><u>\$ 51,681,885</u></u>

Allowance for doubtful accounts:

Premium receivable – other	\$ 4,025,000 (2)
Provider refunds	<u>635,000 (2)</u>
	<u><u>\$ 4,660,000</u></u>

(2) Agrees to the audited statement of net assets.



West Virginia Public Employees Insurance Agency

Due (To) From Primary Government

Form 10

June 30, 2010  
(In Thousands)

<u>Agency</u>	<u>Total</u>
West Virginia Lottery Commission	\$ (2)
Workforce WV/Payroll-05303	2
Workers' Compensation Commission	154
	<hr/> 154
WV Public Employees Retirement Board	171
WV Public Employees Retirement Board	(133)
WV Teachers Retirement Board	(324)
Consolidated Retirement Bd/Judges Ret.	(7)
Deputy Sheriffs Retirement	(120)
Public Safety/Con.Pub.Emp.Ret.Bd.	(14)
	<hr/> (427)
Senate	1
House of Delegates	(11)
Joint Comm on Govt and Finance	24
Supreme Court / Judicial	(5)
Governors Office	(1)
Homeland Security – Emergency Management	1
Auditors Office	3
Treasurer of State's Office	3
Tax Department	43
Tax Department – Budget Office	2
Attorney General	(7)
Secretary of State	2
Department of Education	17
Division of Forestry	18
Library Commission	11
Culture and History	(16)
Department of Corrections	(1)
Anthony Correctional Center	(3)

West Virginia Public Employees Insurance Agency

Due (To) From Primary Government

Form 10 (continued)

*(In Thousands)*

<b>Agency</b>	<b>Total</b>
Huttonsville Correctional Center	286
Pruntytown Correctional Center	8
Northern Correctional Facility	9
Mt Olive Correctional Facility	91
Department of Corrections/St. Marys Corr	90
Department of Corrections/Denmar Facility	1
WV Division of Juvenile Services	73
Ohio County Correctional Center	(7)
Health Department	863
Veterans Affairs	26
Pinecrest Hospital	32
Welch Emergency Hospital	4
William R Sharpe Jr Hospital	8
Mildred Mitchell-Bateman Hospital	244
Lakin State Hospital	11
Lakin Correctional Facility	2
John Manchin Sr. Health Care	31
Hopemont State Hospital	11
Division of Rehabilitation Services	143
Department of Labor	5
Office of Miners Health, Safety and Training	7
Division of Environmental Protection	7
WV Division of Energy	5
Agriculture	(2)
Geological Survey	1
Department of Education and Arts	(6)
Military Affairs and Public Safety	2
Division of Protective Services	1
Environmental Quality Board	(3)
Public Safety	(30)
Adjutant General	(15)
Human Rights Commission	20

# West Virginia Public Employees Insurance Agency

## Due (To) From Primary Government

### Form 10 (continued)

*(In Thousands)*

<b>Agency</b>	<b>Total</b>
Fire Commission	(1)
Department of Highways	205
Motor Vehicles	69
Bureau of Senior Services	(4)
Criminal Justice/Highway Safety	(1)
Public Transit	1
Real Estate Commission	2
Insurance Commission	(74)
WV Board of Accountancy	(1)
WV Board of Dental Examiners	(1)
WV Board of Pharmacy	(1)
WV Engineers Registration Board	1
WV Bd of Examiners/Registered Nurses	9
Department of Administration	3
WV Barbers and Beauticians Commission	8
Public Service Commission	(2)
WV Economic Development Authority	(1)
Natural Resources	3
Municipal Bond Commission	(3)
Board of Examiners In Counseling	(2)
WV Board of Social Worker Examiners	2
ABC Commission	(2)
Board of Respiratory Care	(1)
Department of Human Services	387
Division of Tourism	12
House of Delegates	2
Martinsburg Correctional Center	16
Senate	2
WV Armory Board	8
Board of Medicine	10
Medical Imaging Board	1
WV Division of Banking	(6)

West Virginia Public Employees Insurance Agency

Due (To) From Primary Government

Form 10 (continued)

*(In Thousands)*

<b>Agency</b>	<b>Total</b>
WV Military Authority	(11)
WV Real Estate Appraiser/Lic Cert Bd	(1)
	<u>2,628</u>
Total primary government	2,355
Total component units	(344)
	<u>\$ 2,011</u>

West Virginia Public Employees Insurance Agency

Component Unit – A/R Balances

Form 11

June 30, 2010  
(In Thousands)

<b>Unit</b>	<b>Amount</b>
Higher Education	\$ (440)
Parkways, EDA, and Tourism	(6)
Regional Jail and Correction Facility Authority	53
Public Defender Corporation	28
WV EDA	(1)
Educational Broadcasting	(8)
School Building Authority	(5)
Racing Commission	33
WV Jobs Investment Trust	(1)
Housing Development Corporation	4
Water Development Authority	1
SWMB	(1)
WSWP - TV	(1)
	<u>\$ (344)</u>



## Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Finance Board  
West Virginia Public Employees Insurance Agency

We have audited the financial statements of the West Virginia Public Employees Insurance Agency (PEIA) as of and for the year ended June 30, 2010, and have issued our report thereon dated October 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered PEIA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PEIA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PEIA's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2010-01 to be a material weakness.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether PEIA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PEIA's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit PEIA's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Finance Board, and others within the entity, and is not intended to be, and should not be, used by anyone other than these specified parties.

*Ernst + Young LLP*

October 15, 2010



**STATE OF WEST VIRGINIA  
SCHEDULE OF FINDINGS AND RESPONSES**

**2010-1 INFORMATION SYSTEM CONTROLS)  
(Prior Year Finding 2009-1)**

**State Agency**  
Public Employees Insurance Agency (PEIA)

**Criteria:** Management is responsible for establishing and maintaining adequate controls over changes to and processes to maintain its information systems.

**Condition:** The following IT general controls findings related to the BAS and Great Plains applications were noted:

- **Manage Changes – Authorization, Testing, and Approval**  
During our fiscal year 2009 review of the Great Plains and BAS application change management process, management indicated that the change requests were to be authorized via the weekly task lists; however, we were unable to obtain any documentation surrounding the process. Additionally, no documentation was available to support that the changes/upgrades had been effectively tested and that the change/upgrade obtained final approval for migration to the production environment. Management has indicated that certain changes were recently made to this process and that such changes will be available for testing in future periods.
- **Manage Changes – OS and DB Upgrades/Patches**  
During the 2009 audit of PEIA, it was determined that the process for applying operating system and database upgrades and/or patches (for the Great Plains application) is informal, and no documentation is maintained to support the operating system or database upgrades/patches were authorized, tested, and approved prior to production migration. Management has indicated that certain changes were recently made to this process and that such changes will be available for testing in future audit periods.
- **Logical Access – Password Settings**  
During the 2009 audit of PEIA, it was determined that the Great Plains application password settings, due to functionality limitations, are not configured to 1) be a minimum number of characters in length, 2) force password expirations after a set number of days, 3) lock out user accounts after a defined number of invalid login attempts, and 4) prevent users from reusing their previously used passwords. Management has indicated that no changes have been made to this process.
- **Logical Access – Administrator Access**  
During the 2009 audit of PEIA, it was determined that access to the PROGRAMMER function (which grants users the ability to perform user administration for the BAS application) is not restricted to authorized individuals. This function is granted to three authorized administrators and four programmers. Management has indicated that certain changes were recently made to this process and that such changes will be available for testing in future audit periods.
- **Logical Access – New User Access Authorization**  
During the 2009 audit of PEIA, it was determined that new user access is not consistently documented via e-mails or SATT forms for user access to Great Plains or BAS. Documentation is either not retained or does not include the system whereby access is required, or the type of access to be granted. Management has indicated that no changes have been made to this process.

## STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS AND RESPONSES

### 2010-1 INFORMATION SYSTEM CONTROLS (Prior Year Finding 2009-1) (continued)

**Context:** The information systems conditions noted above could affect the accuracy of processing PEIA financial information, including premiums/contributions.

**Cause:** During the time of our review for the 2009 audit, management was still in the process of defining and implementing their controls related to program change management and logical access processes. Additionally, management was working with the West Virginia Office of Technology to determine where controls are the responsibility of the agency versus the hosting facility.

**Effect:**

- **Manage Changes – Authorization, Testing, and Approval**  
Lack of formal written policies and procedures for application changes and upgrades does not contribute to an effective environment and could lead to inconsistencies in protocol or documentation. Without proper documentation of authorization, user acceptance testing, and migration approval, implemented changes to the production environment may not be operating as intended.
- **Manage Changes – OS and DB Upgrades/Patches**  
Lack of formal written policies and procedures for patches and upgrades does not contribute to an effective environment and could lead to inconsistencies in protocol or documentation. Without proper documentation of authorization, user acceptance testing, migration approval, and implemented changes to the production environment may not be operating as intended.
- **Logical Access – Password Settings**  
The current password settings could lead to unauthorized access to sensitive and/or confidential information.
- **Logical Access – Administrator Access**  
Improper administrator access could lead to inappropriate or excessive user access rights being granted to existing users.
- **Logical Access – New User Access Authorization**  
The lack of controls surrounding the authorization and approval of system access could lead to inappropriate or excessive user access rights being granted to existing users.

**Recommendation:** Based on the findings noted, outlined below are the recommendations:

- **Manage Changes – Authorization, Testing, and Approval**  
Management should implement formal (written) policies and procedures surrounding Great Plains and BAS program changes (modifications or upgrades) to include documentation of authorization, testing, and approval.
- **Manage Changes – OS and DB Upgrades/Patches**  
Management should implement formal (written) policies and procedures surrounding the upgrades and/or patches applied to the operating system and database upgrades supporting the Great Plains application.

**STATE OF WEST VIRGINIA  
SCHEDULE OF FINDINGS AND RESPONSES**

**2010-1 INFORMATION SYSTEM CONTROLS  
(Prior Year Finding 2009-1) (continued)**

- Logical Access – Password Settings  
Management should work with the application vendor to enhance password security. The following are considered leading industry practice.
  - Require passwords to be six to eight characters in length.
  - Force passwords to expire every 60 to 90 days.
  - Automatically lock user accounts after three to five unsuccessful logon attempts.
  - Prevent users from reusing previously used passwords by maintaining a password history file.
  - Automatically lock user accounts after three to five unsuccessful logon attempts.
  - Prevent users from reusing previously used passwords by maintaining a password history file.
- Logical Access – Administrator Access  
Management should restrict access to the privileged roles within the BAS application and limit them to a select number of IT personnel who require such access.  
  
If preventive measures cannot be taken, due to system limitations, management should consider performing a periodic review of all changes to user security for the BAS application to determine if the changes were performed by authorized individuals. Management should confirm that adequate documentation is maintained to provide evidence (sign-offs, hard-copy reports, etc.) of the review.
- Logical Access – New User Access Authorization  
Management should enhance the current application access administration processes to verify that all user access is consistently documented with access details (access needed per system) and management approval is granted prior to gaining access to the systems. Management should verify that adequate documentation is maintained to provide evidence (sign-offs, e-mails, SATT forms, etc.) of the authorization and approval.

**Views of  
Responsible  
Officials and  
Planned Corrective  
Actions:**

Management had devoted substantial efforts to enhance the IT general control environment throughout fiscal year 2010 and some changes were made subsequent to June 30, 2010 to fully address the elements of the finding. Due to unavailability of the support and timing, we requested the auditors not to review IT controls in the current year and to perform a more substantive approach in this area. The following is our response regarding the items identified above:

- Manage Changes – Authorization, Testing, and Approval
  - PEIA believes this issue will be resolved for future audit periods as a result of its recent implementation of the fully functional project tracking system known as PITS (PEIA Issue Tracking System). All functional user requests must be submitted into PITS. The project is then tracked at various levels and may not proceed without user approval of the progress of the project.

## STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS AND RESPONSES

### 2010-1 INFORMATION SYSTEM CONTROLS (Prior Year Finding 2009-1) (continued)

- Manage Changes – OS and DB Upgrades/Patches
  - PEIA believes this will be resolved for future audit periods as a result of its recent implementation of a new process. The process has been set up as follows: Office of Technology (OT) notifies us of Upgrades/Patches. The Upgrades/Patches are automatically applied to our test servers. We test the Upgrades/Patches. Once we complete testing, we schedule with OT to apply upgrades/patches to our production servers.
- Logical Access – Password Settings
  - PEIA will need to upgrade to the most recent version of GP to resolve this issue. This upgrade will proceed when practical.
- Logical Access – Administrator Access
  - PEIA believes this matter will be resolved for future audit periods as a result of access being restricted to authorized users. Administrator Access can only be done by the DYNOSA user. The PEIA OT Project Manager controls access to that user.
- Logical Access – New User Access Authorization

PEIA will continue to track access to its system through SATT. However such tracking will eventually be moved over to PITS, which will provide an appropriate level of documentation.

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