



STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
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KPMG LLP
Suite 600
701 West Eighth Avenue
Anchorage, AK 99501

Independent Auditors' Report

The Division of Retirement and Benefits and
Members of the Alaska Retirement Management Board
State of Alaska Group Health and Life Fund:

We have audited the accompanying financial statements of the State of Alaska Group Health and Life Fund (the Plan), an internal service fund of the State of Alaska, as of and for the years ended June 30, 2018 and 2017, and the related notes to financial statements, which collectively comprise the Plan's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the State of Alaska Group Health and Life Fund as of June 30, 2018 and 2017, and its changes in net position and cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis, on pages 3–7, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

November 21, 2018

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Management's Discussion and Analysis (Unaudited)
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This section presents management's discussion and analysis (MD&A) of the Group Health and Life Fund's (the Plan) financial condition and performance for the years ended June 30, 2018 and 2017. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2018 and 2017. Information for fiscal year 2016 is presented for comparative purposes.

Financial Highlights

The Plan's financial highlights as of June 30, 2018 were as follows:

The Plan's net position increased by \$9.0 million during fiscal year 2018.

- The Plan's health insurance premiums during fiscal year 2018 totaled \$129.6 million, an increase of \$8.0 million from fiscal year 2017.
- The Plan's interest and dividend income during fiscal year 2018 was \$240,595.
- The Plan's benefit expense during fiscal year 2018 totaled \$118.4 million, a decrease of \$5.1 million from fiscal year 2017.
- The Plan's administrative expense during fiscal year 2018 totaled \$4.5 million, a decrease of \$1.2 million from fiscal year 2017.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's financial statements comprise four components: (1) statement of net position; (2) statement of changes in net position; (3) statement of cash flows; and (4) notes to financial statements.

Statement of net position – This statement presents information regarding the Plan's assets, liabilities, and resulting net position. This statement reflects the Plan's cash and cash equivalents, receivables, and other assets less liabilities at June 30, 2018 and 2017.

Statement of changes in net position – This statement presents how the Plan's net position changed during the fiscal years ended June 30, 2018 and 2017, as a result of health insurance premiums, interest and dividend income, and operating expenses.

Statement of cash flows – This statement presents cash flows from operating, financing, and investing activities. The Plan presents its cash flows statement using the direct method for reporting cash received and disbursed during the fiscal year.

The above statements represent resources available for investment and payment of benefits as of June 30, 2018 and 2017 and the sources and uses of those funds during fiscal years 2018 and 2017.

Notes to financial statements – The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules that are essential to a full understanding of the Plan's financial statements.

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Condensed Financial Information

Description	Net position				
	2018	2017	Position increase (decrease)		2016
			Amount	Percentage	
Assets:					
Cash and cash equivalents	\$ 25,754,059	16,985,737	8,768,322	51.6%	\$ 15,095,401
Due from State of Alaska General Fund	57,378	173,114	(115,736)	(66.9)	7,491,389
Other assets	600,446	593,160	7,286	1.2	931,064
Total assets	26,411,883	17,752,011	8,659,872	48.8	23,517,854
Liabilities:					
Claims payable	14,530,000	15,325,000	(795,000)	(5.2)	16,831,000
Accrued expenses	805,787	305,018	500,769	164.2	479,592
Total liabilities	15,335,787	15,630,018	(294,231)	(1.9)	17,310,592
Net position	\$ 11,076,096	2,121,993	8,954,103	422.0%	\$ 6,207,262

Description	Changes in net position				
	2018	2017	Position increase (decrease)		2016
			Amount	Percentage	
Net position, beginning of year	\$ 2,121,993	6,207,262	(4,085,269)	(65.8)%	\$ 14,753,501
Operating revenue:					
Health insurance premiums	129,599,362	121,571,496	8,027,866	6.6	118,044,392
Other revenue	2,048,739	3,444,797	(1,396,058)	(40.5)	2,039,274
Total operating revenue	131,648,101	125,016,293	6,631,808	5.3	120,083,666
Operating expenses:					
Healthcare benefits	118,401,784	123,488,164	(5,086,380)	(4.1)	130,861,656
Administrative	4,532,809	5,716,980	(1,184,171)	(20.7)	5,395,273
Total operating expenses	122,934,593	129,205,144	(6,270,551)	(4.9)	136,256,929
Operating income (loss)	8,713,508	(4,188,851)	12,902,359	(308.0)	(16,173,263)
Nonoperating revenue:					
Interest and dividend income	240,595	103,582	137,013	132.3	127,024
Income (loss) before transfers in	8,954,103	(4,085,269)	13,039,372	(319.2)	(16,046,239)
State of Alaska transfer in	—	—	—	—	7,500,000
Change in net position	8,954,103	(4,085,269)	13,039,372	(319.2)	(8,546,239)
Net position, end of year	\$ 11,076,096	2,121,993	8,954,103	422.0%	\$ 6,207,262

Financial Analysis of the Plan

The statements of net position as of June 30, 2018 and 2017 show total assets exceeding total liabilities by \$11,076,096 and \$2,121,993, respectively. These amounts represent the total plan net position held in trust for healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligation to pay healthcare benefits for its members and their beneficiaries.

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These amounts also represent an increase in net position of \$8,954,103 or 422.0% during fiscal year 2018 and a decrease of \$4,085,269 or 65.8% during fiscal year 2017. Over the long-term, healthcare insurance premiums collected and investment income earned are expected to cover all costs of the Plan. In fiscal year 2018 the plan saw a decrease in covered members as well as a decrease in claim cost per member. During fiscal year 2017, the Plan implemented an insurance premium increase while continuing efforts to contain health claim costs through various measures. In fiscal year 2016, the Plan experienced higher utilization of the health plan and experienced much higher claim costs on a small group of eligible members. During fiscal year 2016, the Plan received a transfer of \$7.5 million from the State of Alaska General Fund. While the Division of Retirement and Benefits (Division) works to maintain a level premium and use of network medical providers to contain costs, medical conditions may exist within the membership that drive costs higher than anticipated. The Division continues to work with the Plan's actuaries and administration to monitor and adjust premiums as needed to help offset these increases. The Division expects that there will continue to be increases in future healthcare costs. The Plan must continue to accumulate assets to meet current and future claim costs.

Insurance Premium Calculations

The overall objective of the Plan is to have sufficient funds to meet claim costs. The insurance premiums are recommended each year by the Division's benefit consultant with the governing body's concurrence and the administrator's approval. Insurance premiums are based on the Plan's benefit year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to recommend premiums for the next benefit year.

Healthcare Insurance Premiums and Investment Income

The revenue required to fund healthcare benefits is accumulated through a combination of employer health insurance premiums, member health insurance premiums, other revenue, and investment income.

	Revenue				
	2018	2017	Increase (decrease)		2016
			Amount	Percentage	
Health insurance premiums	\$ 129,599,362	121,571,496	8,027,866	6.6%	\$ 118,044,392
Other revenue	2,048,739	3,444,797	(1,396,058)	(40.5)	2,039,274
Interest and dividend income	240,595	103,582	137,013	132.3	127,024
Total	<u>\$ 131,888,696</u>	<u>125,119,875</u>	<u>6,768,821</u>	<u>5.4%</u>	<u>\$ 120,210,690</u>

Healthcare insurance premiums paid by the State of Alaska were \$1,555 per month per person in fiscal year 2018 and the second half of fiscal year 2017, and \$1,346 per month per person in the first half of fiscal year 2017 and for fiscal year 2016. Changes to health insurance premiums are the result of actual and anticipated changes in healthcare costs related to covered benefits. Premiums are based on historical and anticipated experience. During fiscal year 2018, there was a decrease of 82 members from fiscal year 2017. This decrease was offset by the increase in insurance premiums paid by the employer and member.

Interest and dividend income increased by \$137,013, or 132.3% from amounts recorded in fiscal year 2017, and decreased by \$23,442 or 18.5% from amounts recorded in fiscal year 2016. The Plan is invested in the General Fund and Other Nonsegregated Investments (GeFONSI). The GeFONSI is an investment pool

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managed by the State of Alaska, Treasury Division in the Department of Revenue. For fiscal years 2018 and 2017, the GeFONSI investments generated 1.02% and 0.56% rates of return, respectively. The GeFONSI annualized rate of return was 0.80% over the last three years and 0.68% over the last five years. The invested balance increased by \$8,768,322 and \$1,890,336 in fiscal years 2018 and 2017, respectively.

Benefits and Expenses

The primary expense of the Plan is the payment of healthcare benefits. These cost of benefits and administering the Plan comprise the cost of operations.

	Expenses				
	2018	2017	Increase (decrease)		2016
			Amount	Percentage	
Healthcare benefits	\$ 118,401,784	123,488,164	(5,086,380)	(4.1)%	\$ 130,861,656
Administrative	4,532,809	5,716,980	(1,184,171)	(20.7)	5,395,273
Total	<u>\$ 122,934,593</u>	<u>129,205,144</u>	<u>(6,270,551)</u>	<u>(4.9)%</u>	<u>\$ 136,256,929</u>

Benefit expenses decreased by \$5,086,380, or 4.1%, from fiscal year 2017 and decreased by \$7,373,492, or 5.6%, from fiscal year 2016. Fiscal years 2018 and 2017 saw a decrease in covered members and a decrease in claims costs per member. Decreases in members are due to ongoing staff reduction efforts by the State of Alaska. Decreases in claims cost per member are a result of improved in-network participation and negotiated discount rates through the third-party administrators.

Administrative expenses decreased by \$1,184,171, or 20.7%, from fiscal year 2017 and increased by \$321,707, or 6.0%, from fiscal year 2016. The decrease in administrative expenses during 2018 was due to fiscal year 2017 being the last year for payments of Patient Protection and Affordable Care Act transitional reinsurance fees as well as decreases in fees paid to third party administrators (TPAs).

Economic Conditions, Market Environment, and Results

Net investment rate of return exceeded the five-year average, ending the year at 150.00% of the five-year rate of return of 0.68%.

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During fiscal year 2018 the plan saw a reduction in administrative expenses and a decrease in per member claim cost. This decrease in overall expenses helped build the fund's reserves. In fiscal year 2016, due to the increased utilization of the health plan, as well as high costs related to a small portion of membership, the Plan saw a drop in available balance for payment of health costs. In this same fiscal year, the Division requested and received an appropriation of \$7.5 million to assist in the cash flow and increase the net position of the Plan. The Division continues to work on ways to reduce costs going forward as well as increase premiums moderately to counteract the drawdown of funds.

The Plan continues to analyze various methods to increase its net position centered around increases to health insurance premiums and working with TPAs to further contain medical costs. In fiscal year 2016, the Division requested and secured additional funding during the 30th Alaska State Legislature in Spring 2017. Additional funding was secured through Conference Committee Substitute (CCS) HB 57, section 26(d) to provide an amount necessary to have an unobligated balance of \$10,000,000 in the Plan at the end of the fiscal year 2018. At fiscal year-end 2018, the net position, unobligated balance, was above \$10,000,000.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the following:

State of Alaska Group Health and Life Fund
Division of Retirement and Benefits, Finance Section
P.O. Box 110203
Juneau, Alaska 99811-0203

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Statements of Net Position

June 30, 2018 and 2017

	2018	2017
Assets:		
Cash and cash equivalents (note 3):		
Investment in State of Alaska General Fund and Other		
Nonsegregated Investments Pool	\$ 25,754,059	16,985,737
Due from State of Alaska General Fund	57,378	173,114
Other assets	600,446	593,160
Total assets	26,411,883	17,752,011
Liabilities:		
Claims payable (note 4)	14,530,000	15,325,000
Accrued expenses	805,787	305,018
Total liabilities	15,335,787	15,630,018
Unrestricted net position	\$ 11,076,096	2,121,993

See accompanying notes to financial statements.

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Statements of Changes in Net Position

Years ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenue:		
Employer health insurance premiums	\$ 110,762,843	104,889,392
Member health insurance premiums	18,836,519	16,682,104
Other revenue	<u>2,048,739</u>	<u>3,444,797</u>
Total operating revenue	<u>131,648,101</u>	<u>125,016,293</u>
Operating expenses:		
Healthcare benefits (note 4)	118,401,784	123,488,164
Administrative	<u>4,532,809</u>	<u>5,716,980</u>
Total operating expenses	<u>122,934,593</u>	<u>129,205,144</u>
Operating income (loss)	8,713,508	(4,188,851)
Nonoperating revenue:		
Interest and dividend income	<u>240,595</u>	<u>103,582</u>
Change in unrestricted net position	8,954,103	(4,085,269)
Total unrestricted net position, beginning of year	<u>2,121,993</u>	<u>6,207,262</u>
Total unrestricted net position, end of year	<u>\$ 11,076,096</u>	<u>2,121,993</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received for premiums from the State of Alaska	\$ 129,599,362	121,571,496
Cash received from third-party administrator	2,041,453	3,444,797
Cash payments for benefits to third-party administrator	(119,196,784)	(124,994,164)
Cash payments to employees	(193,757)	(176,443)
Cash payments to suppliers	(3,722,547)	(5,558,932)
Net cash provided by (used in) operating activities	8,527,727	(5,713,246)
Cash flows from noncapital financing activity:		
Operating subsidies and transfers in from other funds	—	7,500,000
Cash flows from investing activity:		
Interest and dividend income received	240,595	103,582
Net increase in cash and cash equivalents	8,768,322	1,890,336
Cash and cash equivalents, beginning of year	16,985,737	15,095,401
Cash and cash equivalents, end of year	\$ 25,754,059	16,985,737
Reconciliation of operating loss to net cash used for operating activities:		
Operating income (loss)	\$ 8,713,508	(4,188,851)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Decrease (increase) in assets:		
Due from State of Alaska General Fund	115,736	(181,725)
Other assets	(7,286)	337,904
Increase (decrease) in liabilities:		
Claims payable	(795,000)	(1,506,000)
Accrued expenses	500,769	(174,574)
Net cash provided by (used in) operating activities	\$ 8,527,727	(5,713,246)

See accompanying notes to financial statements.

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(1) Description

The following brief description of the State of Alaska Group Health and Life Fund (the Plan), an Internal Service Fund of the State of Alaska (the State), is provided for general information purposes only. Participants should refer to the Select Benefits Information Booklet for more complete information.

General

The Plan was established on July 1, 1997, to provide self-insured healthcare benefits to eligible employees of the State. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's Comprehensive Annual Financial Report (CAFR). As of June 30, 2018 and 2017, there were 5,894 and 5,976 employees, respectively, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for state employees were fully insured through the payment of premiums to an insurance company.

Benefits

The Plan offers medical, dental, vision, and audio benefits to eligible state employees and their dependents.

Eligibility

The Plan does not provide benefits to members of the following collective bargaining units, who chose to receive health coverage through a union trust:

- Labor, Trades, and Crafts Unit
- Public Safety Airport Security Unit
- Public Safety Troopers Unit
- Masters, Mates, and Pilots
- General Government Unit

All other permanent and long-term nonpermanent employees of the State are covered by the Plan, including permanent and long-term nonpermanent seasonal and part-time employees who elect coverage.

The Plan also provides coverage for state legislators and elected officials.

Flexible Benefits

Employees who are not covered through a union trust are eligible for flexible healthcare benefits. A monthly employer premium is paid for each eligible employee under this program. The amount of employer premium paid for each eligible employee is determined by the Department of Administration, Division of Retirement and Benefits and the consulting actuary, and can be adjusted annually. The legislative branch approves the premiums through the budgetary process. Employees select from available coverage options which offer different benefits or pay benefits at different rates. In most instances, the employee is

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responsible to pay a portion of the health costs through a pretax payroll contribution, and the amount of the contribution will vary based on collective bargaining provisions and the employee coverage option selected.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Insurance premiums are recognized as revenue in the period in which they are due. Benefits are recognized when due and payable.

Financial Statement Presentation

The Plan distinguishes operating revenue and expenses from nonoperating revenue and expenses. Operating revenue and expenses generally result from providing services in connection with the Plan's principal ongoing operations. The principal operating revenue of the Plan is employer and member health insurance premiums. Operating expenses for the Plan include benefits and administrative expenses. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Use of Estimates

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

Investments

The Plan participates in the State General Fund and Other Nonsegregated Investments (GeFONSI) pool. GeFONSI invests in fixed-income securities that are valued each business day using an independent pricing service. The Division of Treasury calculates participant's daily cash balance in the GeFONSI by the GeFONSI's actual daily rate of return. Interest is compounded daily.

GeFONSI investment income is distributed to pool participants if prescribed by statute or if appropriated by state legislature.

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in the GeFONSI at June 30, 2018 and 2017. This investment pool has the general characteristics of a demand deposit account.

Administration

The Plan is administered by the State's Division of Retirement and Benefits (the Division). The Division utilizes the services of claims administrators, Aetna, Moda Health, and PayFlex to process all medical, dental, and prescription drug claims. Some of the managed-care vision benefits provided by the Plan are administered by Vision Service Plan.

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Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of insurance premiums from employees, if applicable, and the State. Insurance premium amounts are actuarially determined on an annual basis and adjusted as necessary. The State retains the risk of loss of allowable claims.

Due from (to) State of Alaska General Fund

Amounts due from (to) the State of Alaska General Fund represent the amounts paid by the Plan on behalf of others and amounts paid by others on behalf of the Plan.

Federal Income Tax Status

The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. The Plan is not subject to federal income tax by virtue of the Plan's status as a governmental entity.

(3) Investments

The Department of Revenue, Treasury Division (Treasury) has created a pooled environment by which it manages the investments. The Commissioner of Revenue (the Commissioner) has fiduciary responsibility. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The fund invests in the State's internally managed GeFONSI pool. The GeFONSI consists of investments in the State's internally managed Short-term Fixed Income Pool, Short-term Liquidity Fixed Income Pool, and the Intermediate-term Fixed Income Pool. The complete financial activity of the funds is shown in the State of Alaska CAFR available from the Department of Administration, Division of Finance.

Assets in the pool are reported at fair value. Investment purchases and sales are recorded on a trade-date basis. Securities are valued each business day using prices obtained from a pricing service.

The accrual basis of accounting is used for investment income and GeFONSI investment income is distributed to pool participants monthly if prescribed by statute or if appropriated by the state legislature. Income in the Short-term Fixed Income Pool, Short-term Liquidity Fixed Income Pool, and Intermediate-term Fixed Income Pool is allocated to pool participants daily on a pro rata basis.

The Plan's share of pool investments was as follows:

	June 30, 2018	June 30, 2017
GeFONSI balance	\$ 25,754,059	16,985,737

For additional information on interest rate risk, credit risk, foreign exchange, derivatives, fair value, and counterparty credit risk, see the separately issued report on the Invested Assets of the Commissioner of Revenue at <http://treasury.dor.alaska.gov/Investments/Annual-Investment-Reports.aspx>.

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(4) Claims Payable

The liability for claims incurred but not reported (IBNR) represents the estimated amounts necessary to settle all outstanding claims as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. Claims are reevaluated periodically to consider the effects of inflation, claims settlement trends, and other economic factors. The process of establishing loss reserves is subject to uncertainties that are normal, recurring, and inherent in the healthcare business.

Changes in the balances of claims liabilities during the years ended June 30 were as follows:

	<u>2018</u>	<u>2017</u>
Total, beginning of year	\$ 15,325,000	16,831,000
Healthcare benefits	118,401,784	123,488,164
Benefits paid	<u>(119,196,784)</u>	<u>(124,994,164)</u>
Total, end of year	<u>\$ 14,530,000</u>	<u>15,325,000</u>
End of year:		
Incurred but not reported	<u>\$ 14,530,000</u>	<u>15,325,000</u>
Total, end of year	<u>\$ 14,530,000</u>	<u>15,325,000</u>